September 16, 2005

Memorandum

To: Members of the Board

From: Eileen W. Parlow, Assistant Director

Through: Wendy M. Comes, Executive Director

Subject: **Comments Received on Exposure Draft, *Accounting for Fiduciary Activities* (Tab F)**

> NOTE: The staff prepares Board meeting materials to facilitate discussion of issues at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect authoritative views of the FASAB or its staff. Official positions of the FASAB are determined only after extensive due process and deliberations.

Meeting Objective:
To review summary and staff analysis of public hearing testimony and written comments received on the Exposure Draft, *Accounting for Fiduciary Activities.*

<u>Outreach activities</u>
FASAB published the revised exposure draft (ED), *Accounting for Fiduciary Activities,* on June 27, 2005. Upon release of the ED, notices and/or press releases were provided to: the Federal Register; the FASAB News, the *Journal of Accountancy, AGA Today,* the *CPA Journal, Government Executive,* the *CPA Letter, Government Accounting and Auditing Update,* the CFO Council, the Financial Statement Audit Network, the Federal Financial Managers Council, and committees of professional associations generally commenting on exposure drafts in the past. Copies of the ED and letters requesting comments were also sent to individuals who spoke at the October 2003 public hearing for the original ED, as well as to the Federal Retirement Thrift Investment Board.

During the comment period, FASAB staff also gave informational presentations at the 15th Annual Government Financial Management Conference sponsored by Treasury Agency Services, and at July 2005 meetings of the Financial Statement Audit Network, the OMB Form and Content Work Group, the Greater Washington Society of CPAs, and the U.S. Standard

General Ledger Board's Issues Resolution Committee. A public hearing was also held on August 17, 2005.

Fourteen written responses were received from the following sources:

Comment letters and/or oral testimony provided by:	**Federal (Internal)**	**Non-Federal (External)**
Users, academics, others		3
Auditors	3	
Preparers and financial managers	8	

Note: The response from the Library of Congress (LOC) Office of Inspector General, listed above under "auditors," noted that the response represented the consensus expressed by the Library of Congress Office of the Chief Financial Officer, the Library of Congress Office of the Inspector General, and Kearney & Company, CPAs.

Also, the Deputy Chief Financial Officer of the Social Security Administration (SSA) wrote that the SSA had no comments because SSA funds are primarily earmarked funds rather than fiduciary.

At the public hearing held on August 17, 2005, Zack Gaddy of the Defense Finance and Accounting Service and Debra Carey of the Department of the Interior provided oral statements and answered questions from the Board.

At this writing, the Federal Retirement Thrift Investment Board (FRTIB) has not provided written comments, although an FRTIB staff member provided informational comments to FASAB staff.

The text of the written comments and oral statements appear in Attachment 1; staff analysis and recommendations follow in Attachment 2.

The transcript of the public hearing is being reviewed for accuracy and will be available in the second distribution of briefing materials on September 23, 2005.

Attachments:

1) Text of written comments and oral statements received
2) Summary and staff analysis of comments received
3) Reference material: "Basis of Accounting" from briefing materials, December 2004 Board meeting
4) Exposure Draft, *Accounting for Fiduciary Activities*
5) **(To be sent September 23, 2005)** Transcript of public hearing

Attachments 1: Comments Received

Table of Contents

Written Comments Received:

Oral Statements Received:

AGA

Advancing Government Accountability

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Alexandria, VA 22301

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(703) 548-9367 (fax)

September 12, 2005

Wendy Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Comes:

The Association of Government Accountants (AGA) Financial Management Standards Board (FMSB) appreciates the opportunity to provide comments on the FASAB's Revised Exposure Draft on Accounting for Fiduciary Activities, dated June 27, 2005. The FMSB, comprising 21 members with accounting and auditing backgrounds in federal, state and local government, academia and public accounting, reviews and responds to proposed standards and regulations of interest to AGA members. Local AGA chapters and individual members are also encouraged to comment separately.

This is a very important standard that will be valuable regardless of the method of presenting fiduciary information. The FMSB commends the FASAB for their efforts to bring clarity to one of the most misunderstood concepts in federal financial reporting; this being to differentiate between true fiduciary monies and federal earmarked monies. While we support the requirement to state that fiduciary assets are not assets of the federal government, we believe there should additionally be a requirement to explain the difference in substance and financial statement treatment of earmarked funds and fiduciary funds. This requirement should be included both in the MD&A and in footnote disclosure.

The FMSB has the following comments on the specific questions listed in the section on page 6 of the ED, entitled, "Request for Comments."

1) Definition in paragraph 10 covering all potential fiduciary activity in which Federal entities engage – Most members agreed that the definition in paragraph 10 would be sufficient to cover all potential fiduciary activities. Members did have a few questions. Would this definition include activities such as secondary markets for sales of pooled federally guaranteed loans, such as SBA's Master Reserve Fund used to administer the 7(a) guaranteed loan secondary market? Also, a discussion of fiscal agents may be needed. For example, if a federal entity utilizes a fiscal agent to administer a fiduciary activity are additional disclosures required (e.g., how assurance was gained that fiscal agent's reported transactions and balances are accurate, nature of relationship, fees paid to fiscal agent). Finally, must non-Federal parties hold a 100% interest or is a "partial" interest sufficient?

2) Adequacy of description of payroll withholdings and garnishments – The FMSB thinks that the description appears adequate for payroll withholdings and garnishments. One member recommended expanding the definition of payroll withholdings to include items such as health insurance premiums, federal income taxes, 401-K plans, long-term healthcare accounts, and extended life insurance accounts.

3) Exclusion of payroll withholdings and garnishments from fiduciary reporting requirements – the FMSB agrees that payroll withholdings and garnishments should not be reported as fiduciary.

4) The FMSB agrees that unearned revenue should not be reported as fiduciary.

5) It is the FMSB's opinion that if the fiduciary activity is significant/material (in comparison to non-fiduciary activity), then it should be shown on a separate principal financial statement. (See also our response to question 10.)

6) The FMSB agrees with the requirement in paragraph 17 concerning separate reporting.

7) The FMSB agrees that there should be aggregation of immaterial activities in the applicable footnote for the Financial Report of the U.S. However, there may be cases where "net assets" or "net liabilities" are immaterial, with the "netting" hiding large assets and large liabilities. We suggest that the guidance should include some test to ensure that significant items are not being hidden by the "netting."

8) The FMSB agrees that the proposed standard, together with SFFAS 27, Identifying and Reporting Earmarked Funds, addresses all activities formerly classified as "dedicated collections."

9) The FMSB thinks that the lead time and guidance proposed for agency implementation seems appropriate. Whether the implementation date itself, periods beginning after September 30, 2006, is appropriate depends on when the final standard is adopted.

10) Principal financial statement or footnote disclosure – A majority of the FMSB members prefers the fiduciary activity to be presented in a separate financial statement and not just in notes to the financial statements. A separate statement would be a better presentation and allow for enhanced visibility and greater audit scrutiny. Fiduciary activities should be reported in financial statements subject to full audit. An example that can be cited is of a recent incident with the Individual Indian Trust. The proposed settlement under Cobell v. Norton is $27.487 billion. The lack of accountability and full audit review exacerbated this problem by allowing lost and misused payments and collections to go undetected when they otherwise might have been identified, quantified, and then corrected by agency management in a timely manner.

A minority of FMSB members thinks that sufficient audit coverage could be obtained with a footnote disclosure, especially if OMB Bulletin 01-02, Audit Requirements for Federal Financial Statements, was revised to specifically address the assertions related to the fiduciary disclosure (similar to the requirements listed in 01-02 for performance measure disclosures). Giving fiduciary activity its own stand-alone financial statement does not ensure increased visibility or utility to users of the financial statements. Sophisticated users (e.g., independent auditors, GAO, OMB) should be able to obtain needed information from the footnote disclosure. In addition, a statement of fiduciary activity will not be meaningful to laymen readers (public, legislators) without the narrative disclosures accompanying the financial disclosures.

FMSB members understand that some fiduciary activities prepare financial statements which are subject to independent audit. All FMSB members agree that if a separate set of audited financial statements is available, footnote disclosure in the financial statements of the "host" agency is sufficient, with the footnote also referring the reader to the separately available financial statements.

11) Fiduciary activity reporting requirements for the FR consistent with requirements for component entities – Most members think that reporting at more condensed levels enhances the readability of the Financial Report of the U.S.

Other Items Noted:

A – How many "fiduciary activities" exist? Will this ED and the proposed statement affect many entities or just a few. The ED mentions fiduciary activities for Indian tribes and individuals and the TSP. Are there others that are significant in size? We recommend that the guidance provide additional examples of what would be considered fiduciary activities.

B – The focus of the fiduciary disclosure is on the flow of and status of fiduciary assets. To present a full picture of the activities administered by the fiduciary activity, presentation and disclosure should be made regarding the long-term solvency of the fund/activity (e.g. as of 9/30/XX do assets exist to pay all beneficiaries). Potential penalties stemming from the government's fiduciary responsibility should also be a required disclosure.

C – Can fiduciary activities be "trust" funds? The language is confusing in several places, starting in the Executive Summary on page 4. The sentence starting on the second line, which reads, 'In addition, by clarifying terminology, the Board hopes to avoid confusion regarding federal "trust" funds that are not "fiduciary" in nature.' This can mean that "trust" funds are not fiduciary or that certain "trust" funds are fiduciary and others are not. Similarly paragraph 4 is confusing re "fiduciary" and "trust" funds. Finally, paragraph 36 refers to "trust fund" activity and fiduciary "trust fund" activity. We suggest that these be clarified.

D – It is not clear why footnote 5 is necessary.

E – In paragraph 16d, is the "Schedule of Changes" part of the note disclosure or is it a separate Schedule elsewhere in the financial statement?

The FMSB appreciates the opportunity to comment on the exposure drafts. No members objected to its issuance. This response letter represents a consensus of the views of the FMSB members. We would be pleased to discuss this letter with you at your convenience. You can contact me at hintonrw@audits.state.ga.us or (404) 656-2174 or Anna D. Gowans Miller, CPA, AGA's Technical Manager and facilitator for this project, at amiller@agacgfm.org or (703) 684-6931, ext. 313.

Sincerely,

Russell W. Hinton, CGFM, Chair,
AGA Financial Management Standards Board

cc. Sam M. McCall, MPA, CGFM, CPA, CIA, CGAP
AGA National President

Association of Government Accountants
Financial Management Standards Board

July 2005 – June 2006

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Clarence L. Taylor, Jr.
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Andrew C. West

Relmond P. Van Daniker, Executive Director, AGA (Ex-Officio Member)
Anna D. Gowans Miller, Technical Manager, AGA, Staff Liaison

UNITED STATES DEPARTMENT OF COMMERCE
Chief Financial Officer
Assistant Secretary for Administration
Washington, D.C. 20230

AUG 1 1 2005

Ms. Wendy M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, N.W.
Washington, D.C. 20548

Dear Ms. Comes:

As requested by the Federal Accounting Standards Advisory Board, attached is the Department of Commerce's response to the questions on the exposure draft entitled "*Accounting for Fiduciary Activities.*"

Thank you for providing us with the opportunity to comment on this draft. If you have any questions regarding our comments, please contact Tony Akande at 202-482-0239 or me at 202-482-1207.

Sincerely,

Lisa Casias for
James L. Taylor
Deputy Chief Financial Officer and
Director for Financial Management

Attachment

The Department of Commerce's Response to Questions on FASAB Exposure Draft – *Accounting for Fiduciary Activities*

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

The definition in paragraph 10 is clear and covers all potential fiduciary activities in which Federal entities engage.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

The description of payroll withholdings and garnishments is adequate.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (see "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

Payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements. Reporting payroll withholdings and garnishments in the entity statements is consistent with Generally Accepted Accounting Principles.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (see "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

We agree that unearned revenue should be excluded from the fiduciary reporting requirements. Reporting unearned revenue in the entity statements is consistent with Generally Accepted Accounting Principles.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

The financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities is sufficient.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

We agree that there should be separate reporting for individual fiduciary activities and total fiduciary activity.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government?

The component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government but it should also be disclosed in the notes that immaterial amounts were aggregated for presentation purposes.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, Identifying and Reporting Earmarked Funds, addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

We agree that this proposed standard, together with SFFAS 27, Identifying and Reporting Earmarked Funds, addresses all activities formerly classified as "dedicated collections."

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

The implementation date (periods beginning after September 30, 2006) is appropriate.

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (see Alternate View, page 23.)

Although the Department believes that it is appropriate for each component entity to disclose its portion of the fiduciary activities in the individual entity's financial statement notes, we also believe that a combined Statement of Fiduciary Net Assets should be prepared for the Financial Report of the U.S. Government (FR). The combined statement would use the aggregate of each individual entity's fiduciary activities reported in its footnotes to provide the financial statement reader with a more complete picture of the fiduciary activity.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (see Alternate View, page 26.)

> Yes, we agree that the reporting requirements for the FR should be consistent with requirements for the component entities. As stated in #10 above, a Statement of Fiduciary Net Assets should also be prepared for the FR.

OFFICE OF THE UNDER SECRETARY OF DEFENSE
1100 DEFENSE PENTAGON
WASHINGTON, DC 20301-1100

COMPTROLLER

AUG 30 2005

Ms. Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Comes:

We at the Department of Defense (DoD) are grateful for the opportunity to review and to provide comments on the Federal Accounting Standards Advisory Board Revised Exposure Draft (ED), "Accounting for Fiduciary Activities."

We have two programs, the Iraqi Seized Cash and the Foreign Military Sales (FMS) Program that meet the definition of fiduciary activities. The revised ED contains statements that may exclude the FMS program. As discussed at the public hearing on August 17, 2005, DoD believes the FMS funds, whether originating as foreign customer deposits or as appropriated for the purpose of facilitating the FMS sales, meet the definition of fiduciary activity. We request modifications to paragraph 10 and paragraph 13 of the ED. Detailed comments on our position are enclosed.

My point of contact is Ms. Alice Rice. She may be reached either by e-mail at alice.rice@osd.mil or by telephone at (703) 693-3618.

Sincerely,

T McKay

Teresa McKay
Deputy Chief Financial Officer

Enclosure:
As stated

Department of Defense Comments
Federal Accounting Standards Advisory Board (FASAB)
Accounting for Fiduciary Activities
Statement of Federal Financial Accounting Standards (SFFAS)
Revised Exposure Draft
June 27, 2005

Background Information on the Foreign Military Sales (FMS) Program

The FMS program is a program through which eligible foreign governments purchase defense articles, services, and training from the U.S. government. The purchasing government pays all costs associated with the sale. There is a government-to-government agreement, normally documented on a Letter of Offer and Acceptance between the U.S. government and a foreign government. The articles, services and training may be provided from Department of Defense (DoD) stocks or from new procurement.

For DoD stock items, the FMS Trust Fund (FMSTF) will reimburse the DoD for its cost. The DoD will record and recognize earned revenue. If the DoD requires new procurement, a subsequent contractual arrangement with U.S. vendors is made to provide the article or service requested. For new procurements, the DoD is acting as an “agent” or “pass through entity” for the foreign government. When third-party contractors directly ship the items to the foreign government (DoD does not take physical possession), neither the cost nor revenue is recorded/recognized by the DoD. The FMSTF maintains the fiduciary funds as a non-federal entity until the federal entity (DoD) performs in accordance with the contract, or items are directly shipped to the foreign government by the third-party DoD contractor.

Funding for the FMSTF is provided by the foreign government through advance payments or appropriated by Congress as Foreign Military Financing non-repayable credit funds. Foreign government advance payments to the FMSTF are based on DoD forecasts of financial requirements to ensure funds are available when needed. These funds belong to the foreign country and are to be returned if the program is modified or cancelled. Most of the appropriated non-repayable credit funds are deposited into an interest bearing account in the Federal Reserve Bank and are merged into the FMSTF when required to meet financial requirements.

DoD Responses to the FASAB Questions

Question 1: Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

Answer: No. The U.S. Government appropriates non-repayable credit funds to finance foreign government purchases. These funds are not addressed by the FASAB revised exposure draft (ED). The DoD would like the FASAB to clarify the revised ED to clearly articulate that non-repayable credit funds deposited in the Federal Reserve Bank or merged into FMSTF meet the definition of fiduciary activity. "Judicial remedies," (though potentially available to foreign governments), should not be a requirement for these particular funds to be classified as fiduciary.

Additional Information

The Foreign Military Financing non-repayable credit funds are appropriated in the annual Foreign Operations Appropriations Act to the Executive Office of the President. They are apportioned by the Office of Management and Budget to the Defense Security Cooperation Agency. The foreign countries are allowed to use the funds only for the purposes prescribed by U.S. law and the terms of the Letter of Agreement. In addition, under the authority of the Foreign Assistance Act and the Arms Export Control Act, the U.S. Government may direct the purpose for which the funds may be used.

Most of these funds are deposited in an interest bearing account in the Federal Reserve Bank in the name of the foreign country in accordance with the Arms Export Control Act. Some of these funds in the Federal Reserve Bank account are spent outside the FMS arena in accordance with the Arms Export Control Act. The remaining funds are merged into the FMSTF when required to meet financial requirements of the FMS contracts for goods or services. The country has an ownership interest because it can spend and move the funds as it sees fit within the requirements of the Arms Export Control Act. There is a "binding agreement" in place and it is supported by statute. It is our position that even though the non-repayable credit funds originated as appropriated funds, once they were expended from the originating appropriation to the Federal Reserve Bank interest bearing account or FMSTF, the funds meet the definition of fiduciary activity except for the "judicial remedies" requirement. The foreign country has not had a reason to exercise "judicial remedies" against the U.S. Government for theses appropriated funds, so we do not know if they would prevail in court to enforce the agreement.

Question 2: Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

Answer: Yes.

Question 3: Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

Answer: Yes.

Question 4: Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

Answer: No. The DoD agrees with the intent of the unearned revenue exclusion; however, the DoD requests that the Board clarify in the ED that advance payments received from foreign governments to purchase goods and services under the Arms Export Control Act and placed into the FMSTF do not qualify as unearned revenue. These advance payments are in response to DoD incremental billing statement forecasts. The DoD's position is that these advances are fiduciary and do not meet the definition of unearned revenue because
(1) ownership and control of these funds does not pass until delivery and completion of the order; (2) the DoD has a fiduciary responsibility to the foreign customer to manage and protect the funds until the contractual agreement is fulfilled; and (3) the foreign governments can enforce their ownership interest in the FMSTF in the World Court for breach of fiduciary obligation. The unearned revenue exclusion should not apply to activity in the FMSTF. If paragraph 13 is not modified, then these dedicated collections would appear to not fall under any accounting standard.

Additional Information

While the FMSTF contains funds received in advance of the U.S. government providing goods or services, we believe the account meets the definition of a fiduciary. We have a fiduciary responsibility to foreign governments until a U.S. government agency or military department fulfills the contractual requirements with the foreign customers. The foreign country or foreign entity has the right to use and invest their funds as they see fit until funds are expended from the FMSTF to meet payments to either the U.S. Government or the independent contractor. This position is supported by a Comptroller General Decision dated October 15, 1980 (B-200227 O.M.).

Question 5: Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report (FR) of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

Answer: Yes.

Question 6: Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

Answer: Yes.

Question 7: Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the FR of the U.S. Government?

Answer: Yes.

Question 8: This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

Answer: No. We agree that the standard will do this if our proposed changes mentioned in our answers to Questions 1 and 4 above are made.

Question 9: Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

Answer: Yes.

Question 10: One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

Answer: No. The footnotes are an integral part of the financial statements and are subject to the same audit scrutiny as the statements. The reported information is sufficient as outlined in this exposure draft.

Question 11: One board member disagrees with the proposed reporting requirements for the FR of the U.S. Government. That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

Answer: No. The reporting requirements of the FR are not identical to reporting requirements of the component entities. The FR addresses material information for the audience concerning government-wide activities.

Attachment 1: Written comments and oral presentations received: 4 DoD OIG

From: Wendolyn M Comes
To: Parlow, Eileen W
Date: 8/24/2005 11:51:39 AM
Subject: Fwd: DoDIG Comments on proposed SFFAS entitled "Accounting for Fiducia ry Activities." : UNCLASS

>>> "Peek, Marvin L., OIG DoD" <mpeek@dodig.osd.mil> 08/24/05 11:43 AM >>>
UNCLASSIFIED DOCUMENT

We have reviewed the exposure draft on fiduciary activities and have no matters of disagreement with the proposed standard. However, DoD must determine the appropriate classification and reporting requirements for the Foreign Military Sales (FMS) Trust Fund based on the requirements that will be established upon FASAB's issuance of the final standards. The DoD OIG position regarding the FMS Trust Fund, is that it is not a fiduciary activity and is not subject to the provisions of the exposure draft regarding fiduciary activities because the FMS Trust Fund consists primarily of advance payments for goods and services to be received. The DoD OIG plans to work with the OUSD(C), Defense finance and Accounting Service and Defense Security Cooperation Agency ensure that the reporting of the FMS Trust Fund complies with the standards established by FASAB

Marvin (Leon) Peek, CPA

Program Director

DoD Agency-Wide Financial Statements

Defense Financial Auditing Service

703-325-5777

UNCLASSIFIED DOCUMENT

Greater Washington Society of CPAs and GWSCPA Educational Foundation

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August 3, 2005
Wendy Comes, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6K17V
441 G Street, NW – Suite 6814
Washington, DC 20548

Dear Ms. Comes:
The Greater Washington Society of Certified Public Accountants (GWSCPA) Federal Issues and Standards Committee (FISC) appreciates the opportunity to provide comments on the Federal Accounting Standards Board's (FASAB) Revised Exposure Draft *Accounting for Fiduciary Activities*, dated June 27, 2005.
FISC consists of 18 GWSCPA members who are active in accounting and auditing in the Federal sector. This comment letter represents the consensus comments of our members.

General Observation
FISC congratulates FASAB for clarifications and improvements in the Revised ED.

Responses to Request for Comments – Page 6 of Revised ED
1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

FISC believes that the definition in Paragraph 10 may open the way for clearly non-fiduciary activities to be accounted for outside the entity, e.g., outstanding checks, contractor bid deposits, "good faith" deposits or bonds from prospective buyers of Federal government property, etc. Further, there are many circumstances where the Federal government collects revenues, e.g., excise taxes, that are later distributed under a formula to state or local governments; an example is oil and gas royalties collected by the Department of the Interior (Interior) and later distributed to states. Paragraphs 11 through 13 should be expanded to cover such examples. FISC understands that a principal purpose of the Revised ED is to limit fiduciary activities, not to inadvertently expand them.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

Yes. However, FISC suggests that FASAB clarify the reason that payroll withholdings and garnishments are excluded. Presumably, the exclusions are that non-Federal individuals and entities have no ownership interest in such items until they are paid by the Federal entity and, thus, are essentially the same as any other entity liability, e.g., vendor payables, accrued payroll, etc.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

Yes. However, paragraph 46 should be expanded to encompass comments in Questions 1 and 2 above.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraphs 46.)

Yes.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? (See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government.) (See paragraphs 35-58 in the Basis for Conclusions for the rationale.)

Yes, with respect to a Federal component entity. With respect to the Financial Report of the USG (FRUSG), because each Federal component entity will have a different materiality standard, the larger Federal component entities (DOD, SSA, HHS, etc.) may not report fiduciary activities that are material to and would be reported by smaller Federal component entities.

One of our members agrees with the Alternative proposed by the one board member who disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a financial statement subject to full audit scrutiny. However, rather than create another stand alone financial statement, FASAB should consider combining the Statement of Custodial Activity to include fiduciary activity. It could be called the Statement of Custodial and Fiduciary Activity. The format could be designed to separate the custodial activity from the fiduciary activity. The format presented for the Increase in Net Assets for the alternative Schedule of Fiduciary Activity is very similar to the format for the Statement of Custodial Activity. If this approach were taken, asset and liability accounts would remain on the face of the balance sheet (identified appropriately).

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

Yes. However, FISC believes that, when more than one Federal component entity is responsible for a fiduciary activity, each reporting Federal component entity should disclose the other entities that are partially responsible. This will minimize, for example, reporting of a 50% "interest" by one entity and no reporting by the other entity's "interest" on materiality standards as mentioned in Question 5 above.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U. S. Government?

Yes. However, if this requirement is effectively applied to the FRUSG, supplemental reporting will be necessary to aggregate non-reported fiduciary activities at the USG level.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (See paragraph 32 of the Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

Yes.

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

Yes.

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. The member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

FISC agrees that footnote reporting is appropriate. However, three significant fiduciary activities – The Thrift Savings Plan (which has not heretofore been reported in the FRUSG), and the two Interior-administered Indian Trust Funds (which heretofore have been reported in the PAR of Interior and in the FRUSG) are audited by independent auditors and their financial reports are available to the public, particularly the beneficiaries. FISC believes that, if a fiduciary activity is material to the Federal component unit, footnote disclosure is appropriate; FISC recommends that, as in the state and local government environment, disclosure should include how a reader of an entity's PAR and the Financial Report of the USG can obtain such financial reports. A reader of an entity's PAR or the FRUSG, principally interested in the fiduciary activity, should be able to obtain such financial reports via this disclosure, which is not encompassed in the Revised ED.

One member agrees with this alternative approach. However, rather than a stand alone financial statement, fiduciary activities should be included with the Statement of Custodial Activity (as a separate section). See response to question 5 above.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

No. FISC understands that the nature of each fiduciary activity of a Federal component unit is unique. Thus, at the Federal component entity level, the disclosure may well be more detailed than the summarized information in the FRUSG. For example, a major international public company may summarize the numerous pension plans of its subsidiaries, while the separate report of one of the subsidiaries may well have more disclosure for the particular plan(s) of the subsidiary than the consolidated financial report has for all of the plans. To have exact duplication of the myriad disclosures of each of the Federal component entities could well expand fiduciary activity disclosures to exceed all other financial disclosures in the FRUSG. This will also impact the guidance in Paragraph 20.

Additional Specific Comments

- **Effective Date** (Paragraph 9) – FISC recommends that those Federal component entities that have been reporting their fiduciary activities essentially in accordance with the provisions of the ultimate standard in the Revised ED be permitted to continue to do so and the early adoption prohibition be altered to permit this. This also impacts Paragraphs 35 and 55.

- **Characteristics** (Paragraph 11) – FISC recommends that this paragraph be expanded to specifically distinguish fiduciary activities from earmarked funds. FISC does not believe that earmarked funds are fiduciary activities.

- **Reporting Fiduciary Activities** (Paragraph 16d) – Since non-valued seized property generally is held until legal action related thereto is concluded and the assets returned to the owner (property seized in error) or destroyed (e.g., illegal drugs, non-taxed alcohol, or cigarettes, etc.), FISC believes that, except in unusual situations, disclosure of this information is not relevant. Accordingly, FISC suggests that the illustration on page 33 of the Revised ED on seized illegal drugs be eliminated from the illustration.

- **Effect on Current Standards** (Paragraph 29) – The last word in this paragraph should be "beneficiaries" vs. "beneficiary".

- **Appendix A** (Paragraph 50) – In the last sentence, FISC suggests that this be expanded to "…made by such banks' trust departments…"

- **Appendix B** (Glossary) – FISC suggests that Earmarked Funds and Non-Entity Funds be added to the glossary even though they are defined in other FASAB standards.

- **Appendix D** (Pro Forma Transactions) – FISC believes that this Appendix is not necessary since it is unlikely that it includes all such transactions which can be encountered by Federal component entities.

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This comment letter was reviewed by the members of FISC, and represents the consensus views of our members.

Very truly yours,

Daniel L. Kovlak
FISC Chair

+

From: Wendolyn M Comes
To: Parlow, Eileen W
Date: 8/31/2005 7:54:29 AM
Subject: Fwd: HUD's Comments on FASAB's Exposure Draft on Accounting for FiduciaryActivities

>>> <Frank_J._Murphy@hud.gov> 08/30/05 6:33 PM >>>
The attached document contains HUD's comments on FASAB's revised exposure draft of a proposed Statement of Federal Financial Accounting Standards entitled "Accounting for Fiduciary Activities."

Regarding question #5 on the Request for Comments, HUD agrees with the proposal that fiduciary assets and liabilities be disclosed in a separate footnote to the financial statements. However, HUD disagrees with the proposal to not recognize fiduciary assets and liabilities on the face of the balance sheet. HUD believes that the reader is better served by displaying fiduciary information prominently in the balance sheet, with a clarifying footnote, rather than only in the footnotes.

If you need any further information, please contact Ken Bigley by telephone at (202) 708-0614 extension 6903, or by e-mail at Kenneth_G._Bigley@hud.gov.

v/r
Frank

Frank_J._Murphy@HUD.GOV
Director, Financial Policy and Procedures Division
HUD HQ, Room 5143
202-708-0614 Ext. 3466

Request for Comments
Federal Accounting Standards Advisory Board
Exposure Draft – Accounting for Fiduciary Activities
June 2005

HUD Responses to FASAB Request for Comments

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

The definition appears reasonable. The definition of a fiduciary activity notes that:

- A Federal entity collects or receives, and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities have an ownership interest that the Federal Government must uphold.
- The ownership interest is under provision of law, regulation, or other fiduciary arrangement, and enforceable against the Federal Government. Judicial remedies must be available for the breach of fiduciary obligation.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

HUD agrees with the description for payroll withholdings and garnishments. The definitions follow:

- Garnishments - Garnishments are a method of debt collection in which a portion of a person's salary or tax refund is paid to a third party in compliance with a statute or court order.

- Payroll withholdings – Amounts that are withheld from payment of wages to an employee and subsequently remitted to other payees, such as Federal, State or local governments; or health or life insurance providers, on behalf of the employee.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

HUD agrees – Liabilities for payroll withholdings and garnishments should be recognized as accounts payable in accordance with existing standards.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

HUD agrees. Assets collected or received by a Federal entity that represents prepayments or advance payments for which the Federal component entity is expected to provide goods or services should not be classified as fiduciary activity.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

HUD disagrees with the exposure draft's proposal that fiduciary assets not be recognized on the balance sheet. HUD believes the fiduciary component should be shown on the balance sheet as a non-entity asset with a corresponding liability, *NOT* as a separate statement.

With the exception noted above, HUD agrees with the financial note reporting disclosures described in the exposure draft for component entities and for the Financial Report of the U.S. Government. These treatments are described below:

For the Federal Component Entities -
A separate note to the financial statements should include the following information for individual fiduciary activities:
–Narrative describing the fiduciary relationship and activity
–Schedule of Fiduciary Activity
–Schedule of Fiduciary Net Assets

For the Financial Report of the US Government -
Fiduciary note disclosure would include:
–Definition of "fiduciary activity"
–Description of the nature of the Federal Government's fiduciary activities
–List of Federal component entities responsible for fiduciary assets, and for each period presented, the total dollar amount of fiduciary net assets for each Federal component entity, with immaterial entities aggregated
–In the initial year of implementation, prior year information should not be displayed. In the reporting periods following the initial year of implementation, prior period amounts should be displayed.
–Refer to the individual Federal entity financial statements for more information

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

HUD agrees with separate reporting if more than one Federal component entity is responsible for administering a fiduciary activity with the requirements of paragraph 17 applied.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government?

HUD agrees that immaterial entities can be aggregated.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, Identifying and Reporting Earmarked Funds, addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

HUD agrees.

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

HUD would prefer an implementation date for periods beginning after September 30, 2007. This date would allow HUD to provide time for posting model and financial reporting template changes.

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

HUD does not agree. We believe the Revised Exposure Draft provides sufficient information.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

HUD agrees with the Alternative View that reporting should be consistent; we believe otherwise useful information would be lost in the FR. We also believe that agencies should be able to report/present similarly to paragraph 23 as for the FR.

United States Department of the Interior
OFFICE OF THE SPECIAL TRUSTEE FOR AMERICAN INDIANS
Washington, D.C. 20240

AUG 30 2005

Ms. Wendy M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW
Washington, D.C. 20548

Dear Ms. Comes:

We would like to take this opportunity to follow up with you regarding the Department of the Interior's testimony and responses to questions from the Federal Accounting Standards Advisory Board during the public hearing regarding "Accounting for Fiduciary Activities" Exposure Draft, held on August 17, 2005. Our intent is to clarify our comments and to present in writing what we believe to be the major issues involved with accounting for fiduciary activities.

We agree that the footnote disclosure should contain information relating to the fiduciary relationship between the governmental entity and the various classes of beneficiaries. This information is important to the lay reader as it describes the Federal government's fiduciary responsibilities and the approach in which the trust funds are managed. Essentially, it provides meaningful information to the reader.

While we agree with the requirement to disclose significant fiduciary activities, we believe the required disclosure should be consistent with the standard disclosure requirement for the trust activity of commercial banks and savings institutions. Per the AICPA Audit and Accounting Guide for Banks and Savings Institutions, the objective of disclosing trust activities in the footnotes to a bank's financial statements is to disclose any SFAS 5 (FASB Statement No. 5) contingencies (i.e. contingent liabilities) that may exist, as well as any fees that are earned by the bank through the performance of the trust activity. Please see enclosure 1 for an example of a major bank's footnote disclosure on trust accounts.

Based on the objectives as stated by the AICPA, we do not believe the disclosure should require the re-casting of a set of financial statements, which are already audited on a stand-alone basis, in the footnotes of another set of financial statements. In addition, we believe that amounts required to be presented in a footnote disclosure should agree to amounts already presented in the stand-alone audited financial statements of the significant fiduciary activity. The stand-alone financial statements for the Indian Trust Funds are prepared on an other comprehensive basis of accounting, as the measurement focus of the stand-alone financial statements is on amounts currently available to the beneficiary, not amounts which may become available through future events.

Currently, the Office of the Special Trustee for American Indians reports account balances and transactions, and investment holdings and earnings information to the trust beneficiaries in their periodic statements of account. Also, we are currently in the process of providing additional information to the trust beneficiaries through a nationwide rollout of an expanded statement of account. The additional information currently includes the number and description of acres held in trust, and the key terms of lease agreements and contracts. At a future date, additional enhancements will include the reporting of amounts due under lease agreements and contracts. The form and content of the additional information is consistent with information provided by commercial trust systems. Please see enclosures 2 and 3 for examples of information that is provided to beneficiaries who are currently receiving the expanded statements of account.

In summary, we strongly support the requirement to disclose significant fiduciary activities and believe that the information should satisfy one key objective, to clearly and concisely describe the fiduciary activity and any contingent liabilities resulting from the activity. We believe the most effective and meaningful approach is to disclose amounts under the same basis of accounting as amounts that are presented elsewhere to the public in stand-alone audited financial statements.

Thank you for allowing me the opportunity to clarify our views on these issues. If you have any questions regarding this letter, please feel free to call me at (202) 208-4866, or Ms. Margaret Williams, Deputy Special Trustee – Trust Services at (505) 816-1072.

Sincerely,

Margaret Williams

for Ross O. Swimmer
Special Trustee for American Indians

Enclosures (3)

ENCLOSURE 1

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

☒ ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: December 31, 2003

or

☐ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number: 0-7275

CULLEN/ FROST BANKERS, INC.

(Exact name of registrant as specified in its charter)

Texas	74-1751768
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
100 W. Houston Street, San Antonio, Texas	78205
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code:
(210) 220-4011

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, $.01 Par Value, and attached Stock Purchase Rights	The New York Stock Exchange, Inc.
(Title of each class)	(Name of each exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

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	Payments Due by Period				
	1 year or less	More than 1 year but less than 3 years	3 years or more but less than 5 years	5 years or more	Total
[illegible]					
Subordinated notes payable	$ —	$ —	$ —	$ 150,000	$ 150,000
[illegible]					
Federal Home Loan Bank advances	1,856	512	305	79	2,752
[illegible]					
Deposits with stated maturity dates	971,417	78,797	227	100	1,050,541
	984,596	99,148	16,141	279,440	1,379,325
[illegible]					
Loan commitments	29,542	1,797,535	373,769	165,983	2,366,829
[illegible]					
[illegible]					
[illegible]					

In the normal course of business, the Corporation enters into various transactions, which, in accordance with accounting principles generally accepted in the United States, are not included in its consolidated balance sheets. The Corporation enters into these transactions to meet the financing needs of its customers. These transactions include commitments to extend credit and standby letters of credit, which involve, to varying degrees, elements of credit risk and interest rate risk in excess of the amounts recognized in the consolidated balance sheets. The Corporation also holds certain assets which are not included in its consolidated balance sheets including assets held in fiduciary or custodial capacity on behalf of its trust customers and certain collateral funds resulting from acting as an agent in its securities lending program.

Loan Commitments. The Corporation enters into contractual commitments to extend credit, normally with fixed expiration dates or termination clauses, at specified rates and for specific purposes. Substantially all of the Corporation's commitments to extend credit are contingent upon customers maintaining specific credit standards at the time of loan funding. The Corporation minimizes its exposure to loss under these commitments by subjecting them to credit approval and monitoring procedures. Management assesses the credit risk associated with certain commitments to extend credit in determining the level of the allowance for possible loan losses. Loan commitments outstanding at December 31, 2003 are included in the table above.

Standby Letters of Credit. Standby letters of credit are written conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. In the event the customer does not perform in accordance with the terms of the agreement with the third party, the Corporation would be required to fund the commitment. The maximum potential amount of future payments the Corporation could be required to make is represented by the contractual amount of the commitment. If the commitment is funded, the Corporation would be entitled to seek recovery from the customer. The Corporation's policies generally require that standby letter of credit arrangements contain security and debt covenants similar to those contained in loan agreements. Standby letters of credit outstanding at December 31, 2003 are included in the table above.

Trust Accounts. The Corporation also holds certain assets in fiduciary or custodial capacity on behalf of its trust customers. The estimated fair value of trust assets was approximately $14.8 billion (including managed assets of $6.6 billion and custody assets of $8.2 billion) at December 31, 2003. These assets were primarily composed of equity securities (45.9% of trust assets), fixed income securities (36.4% of trust assets) and cash equivalents (10.5% of trust assets).

Securities Lending. The Corporation lends certain customer securities to creditworthy brokers on behalf of those customers. If the borrower fails to return these securities, the Corporation indemnifies its customers

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Corporation will discontinue hedge accounting prospectively. At such time, previous adjustments to the carrying value of the hedged item are reversed into current earnings and the derivative instrument is reclassified to a trading position recorded at fair value.

The Corporation may be required to recognize certain contracts and commitments as derivatives when the characteristics of those contracts and commitments meet the definition of a derivative.

Fair Values of Financial Instruments. Fair values of financial instruments are estimated using relevant market information and other assumptions. Fair value estimates involve uncertainties and matters of significant judgment regarding interest rates, credit risk, prepayments, and other factors, especially in the absence of broad markets for particular items. Changes in assumptions or in market conditions could significantly affect the estimates. The fair value estimates of existing on- and off-balance sheet financial instruments do not include the value of anticipated future business or the value of assets and liabilities not considered financial instruments.

Transfers of Financial Assets. Transfers of financial assets are accounted for as sales when control over the assets has been surrendered. Control over transferred assets is deemed to be surrendered when (i) the assets have been isolated from the Corporation, (ii) the transferee obtains the right (free of conditions that constrain it from taking advantage of that right) to pledge or exchange the transferred assets, and (iii) the Corporation does not maintain effective control over the transferred assets through an agreement to repurchase them before their maturity.

Loss Contingencies. Loss contingencies, including claims and legal actions arising in the ordinary course of business are recorded as liabilities when the likelihood of loss is probable and an amount or range of loss can be reasonably estimated.

Trust Assets. Assets of the Corporation's trust department, other than cash on deposit at Frost Bank, are not included in the accompanying financial statements because they are not assets of the Corporation.

Note 2 — Acquisitions

The acquisitions described below were accounted for as purchase transactions with the total cash consideration funded through internal sources. The purchase price has been allocated to the underlying assets and liabilities based on estimated fair values at the date of acquisition. The operating results of the acquired companies are included with the Corporation's results of operations since their respective dates of acquisition. None of the acquisitions had a significant impact on the Corporation's financial statements.

During the first quarter of 2003, the Corporation acquired Brokers Insurance Designs, an independent insurance agency based in Fort Worth, Texas. The acquired company, which offered group employee benefit plans, was fully integrated into Frost Insurance Agency.

During the second quarter of 2002, the Corporation acquired the branch facility and certain deposits of the Harlingen, Texas branch of another financial institution. The Corporation assumed approximately $20.0 million in deposits in connection with the acquisition.

During the third quarter of 2001, the Corporation acquired AIS Insurance & Risk Management, an independent insurance agency based in Fort Worth, Texas. The acquired company, which offered a broad range of commercial insurance products, business succession planning services and risk management services, was fully integrated into Frost Insurance Agency.

ENCLOSURE 2

STATEMENT OF ACCOUNT

Account Holder Name
Account Holder Address

Account Number

TRANSACTION ACTIVITY FOR ACCOUNTING PERIOD: 06/01/05 THROUGH 06/30/05

DATE	TRANSACTION DESCRIPTION	AMOUNT
06/01/05	Beginning Balance	$100.00
06/03/05	Cash Receipt Monthly Income Earned May 2005 Income at the Annualized Rate of 5.02%	0.43
06/10/05	Cash Receipt Oil and Gas Royalty	35.00
06/15/05	Cash Disbursement Paid To: Check or ACH #:	-50.00
06/30/05	Ending Balance	$85.43

ENCLOSURE 2

LIST OF REAL PROPERTY ASSETS

Account Holder Name
Account Number

AS OF 06/30/05

REAL PROPERTY

UNDIVIDED OWNERSHIP	TRACT ID TRACT DESCRIPTION	TRACT ACRES	LOCATION	OWNERSHIP CLASSIFICATION
1.00000000	12345 General Description	100.000	General Description	Beneficial
0.50000000	* 67890 General Description	50.000	General Description	Beneficial

* ENCUMBRANCES

TRACT ID	DOCUMENT ID	ENCUMBRANCE TYPE	ENCUMBRANCE HOLDER	EFFECTIVE DATE	EXPIRATION DATE
67890	ABCDEF	Oil and Gas Lease	ABC Corp.	7/25/2002	7/31/2007

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ENCLOSURE 2

LIST OF REAL PROPERTY ASSETS

Account Holder Name
Account Number

LEGEND

ACCOUNT NUMBER:	This is your account number and land owner ID.
UNDIVIDED OWNERSHIP:	This is the undivided ownership interest you own in the respective tract and/or encumbrances.
TRACT ID:	This is the unique number assigned to the tract of land; when preceded by an asterisk ("*"), the tract is encumbered.
OWNERSHIP CLASSIFICATION:	The following are the different ownership classifications that could be listed on your statement: - "Title" only - The account holder has title, but not beneficial ownership to the land. A title only account holder does not receive income derived from the encumbrance activity. - "Beneficial" only - The account holder has beneficial, but not title ownership to the land. A beneficial only account holder receives income derived from encumbrance activity. Beneficial ownership reverts to the title owner/remainderman upon the beneficial owner's death. - "Title and Beneficial" - The account holder has both title and beneficial ownership to the land. A title and beneficial account holder receives income from encumbrance activity
ENCUMBRANCE/ENCUMBERED:	Any lease, right of way, permit, or any other legal instrument which authorizes use of the property.
DOCUMENT ID:	Assigned number to identify the encumbrance document.
EFFECTIVE DATE:	Date the encumbrance starts.
EXPIRATION DATE:	Date the encumbrance ends if there is an end date, or - HBP = Held by production, or - IP = In perpetuity (the encumbrance does not have an expiration date)

ENCLOSURE 3

ASSET SUMMARY

Account Holder Name
Account Number

AS OF 06/30/05

PAGE 1

ASSET CATEGORY	COST	PERCENT OF ACCOUNT AT MARKET	MARKET VALUE	UNREALIZED GAIN/LOSS (COST TO MKT)	ESTIMATED ANNUAL INCOME	INCOME YIELD AT COST
PRINCIPAL PORTFOLIO						
US TREASURY OVERNIGHTER	2,986.24	1.32%	2,986.24	0.00	95.00	3.18%
US GOVT SPONS ENTITY ISSUES	194,919.00	86.45%	195,717.90	798.90	7,263.00	3.73%
PRINCIPAL PORTFOLIO TOTAL	197,905.24	87.77%	198,704.14	798.90	7,358.00	3.72%
INVESTED INCOME PORTFOLIO						
US TREASURY OVERNIGHTER	27,687.39	12.23%	27,687.39	0.00	883.00	3.19%
INVESTED INCOME PORTFOLIO TOTAL	27,687.39	12.23%	27,687.39	0.00	883.00	3.19%
TOTAL ASSETS	225,592.63	100.00%	226,391.53	798.90	8,241.00	3.65%

ENCLOSURE 3

LIST OF FINANCIAL ASSETS

Account Holder Name
Account Number

AS OF 06/30/05

PAGE 2

PAR VALUE OR SHARES	ASSET DESCRIPTION	COST	MARKET VALUE AND % OF ACCOUNT	UNREALIZED GAIN/LOSS (COST TO MKT)	ESTIMATED ANNUAL INCOME	INCOME YIELD AT COST
PRINCIPAL PORTFOLIO						
US TREASURY OVERNIGHTER						
2,986.2400	US Treasury Overnighter CUSIP: 123	2,986.24	2,986.24 1.32%	0.00	95.00	3.18%
US GOVT SPONS ENTITY ISSUES						
125,000.0000	FEDERAL HOME LOAN BANK DTD 05/05/2005 FLTG CPN 05/05/2006 FLOATING RATE NOTE DUE 05/05/06 CUSIP: 456	124,975.00	125,000.00 55.21%	25.00	3,763.00	3.01%
70,000.0000	5.00% FHLB DUE 10/27/2014 CALLABLE ONE TIME ONLY 10/27/2006 CUSIP: 789	69,944.00	70,717.90 31.24%	773.90	3,500.00	5.00%
TOTAL US GOVT SPONS ENTITY ISSUES		194,919.00	195,717.90 86.45%	798.90	7263	3.73%
PRINCIPAL PORTFOLIO TOTAL		197,905.24	198,704.14 87.77%	798.90	7,358.00	3.72%
INVESTED INCOME PORTFOLIO						
US TREASURY OVERNIGHTER						
27,687.3900	US Treasury Overnighter CUSIP: 123	27,687.39	27,687.39 12.23%	0.00	883.00	3.19%
INVESTED INCOME PORTFOLIO TOTAL		27,687.39	27,687.39	0.00	883.00	3.19%

United States Department of the Interior
Office of the Secretary
Washington, DC 20240

September 8, 2005

Ms. Wendy M. Comes
Executive Director
Federal Accounting Standards Advisory Board
441 G Street, NW
Washington, D.C. 20548

Dear Ms. Comes:

Thank you for the opportunity to comment on the Federal Accounting Standards Advisory Board Exposure Draft, "Accounting for Fiduciary Activities." The Department of the Interior concurs with the requirement for note disclosure of significant fiduciary activities, including the Thrift Savings Plan and Indian Trust Funds, as specified in the Exposure Draft.

Our two primary comments relate to the definition of Fiduciary assets and the basis for financial amounts to be reported in the Notes to the Financial Statements. Additional comments regarding the Exposure Draft, including the use of materiality in determining the application of the Fiduciary definition, Minerals Management Service Custodial Activity Disclosures, and the sample footnote disclosures and pro forma transactions provided in the Appendices are discussed in more detail in Enclosure A. Please see Enclosure B for our response to the specific questions raised in the Exposure Draft.

Definition of Fiduciary Assets

In our previous comments, we stated that we concurred with the definition of Fiduciary Assets. Our position on the scope of Fiduciary Assets is unchanged. Specifically, we believe that the reporting requirements in this document for Fiduciary Assets should be applied to an extremely narrow group of assets. In these limited situations, the assets should not be presented on the balance sheet of any Federal agency.

However, since the release of the original Exposure Draft, we have noted that the Fiduciary Asset definition has been interpreted more broadly than we feel is correct. In fact, the need for stated exclusions of payroll withholdings and advances related to the sale of goods and services indicate that the definition is sweeping in activities well beyond our initial interpretation of the fiduciary definition. In general, we believe that Fiduciary Asset treatment is appropriate for the Thrift Savings Plan and Indian Trust Funds. These activities share certain characteristics, including:

1) An absolute certainty of non-federal ownership.
2) A contractual arrangement governing the relationship between the Federal Government and the Trust beneficiaries. This contract may be in the form of legislation and/or regulation.
3) The contractual arrangement, explicitly or implicitly, requires that specific accountability and reporting standards be met. Evidence of this accountability might include, but is not limited to, the following:
   a) Maintenance of a self balancing set of accounts for the fund.
   b) Issuance of regular, periodic statements to account owners indicating opening balance, additions, withdrawals, and closing balance.
   c) Independent audit of the self-balancing set of accounts.

We believe that all assets, regardless of label, not meeting this high level of fiduciary control should remain on the balance sheet of the agency as an asset and offsetting liability. Paragraph 45 of the Basis for Conclusions supports this view with the inclusion of a quote that states, "*a fiduciary relationship necessarily arises when the Government assumes such elaborate control over forests and property belonging to Indians. All of the necessary elements of a common-law trust are present: a trustee (the United States), a beneficiary (the Indian Allottees), and a trust corpus (Indian timber, lands, and funds).*" Expansion of the Fiduciary definition to activities that do not demonstrate "elaborate control" or the "necessary elements of a common law trust" is not appropriate.

In addition, the terms of certain earmarked funds, including the Abandoned Mine Land (AML) Fund managed by the Office of Surface Mining Reclamation and Enforcement, are such that portions of an activity might meet the earmarked definition while other portions have the potential to be considered "fiduciary" if certain conditions are met. We believe that SFFAS number 27, "Identifying and Reporting Earmarked Funds" provides appropriate guidance for the entirety of this activity and that disclosure of funds such as the AML fund in one place as one fund provides the best information to the user of Federal financial reports.

<u>Fiduciary Disclosures</u>

Communications with Indian Trust Fund beneficiaries include periodic statements and an audited annual financial report. The audited financial statements of the Indian Trust Funds are prepared on another comprehensive basis of accounting. Statements provided to trust beneficiaries include account balances, transactional information, and investment holdings, but exclude certain amounts which have not yet been collected and deposited into the accounts. The Office of the Special Trustee is in the process of adding additional information to beneficiary statements, including the number and description of acres held in trust and the terms of lease agreements and contracts. In order to provide meaningful, accurate and consistent information to the public and trust beneficiaries, we believe that the requirements of paragraph 14 should be adjusted to require that the disclosures in the notes to agency financial statements be prepared on the same basis as other communications with trust beneficiaries. If accruals of transactions not reflected in beneficiary accounts are included in agency footnote disclosures, the result would be the publication of two different amounts related to the same trust accounts. This is likely to create confusion and reduce the usefulness of the information.

Thank you again for the opportunity to comment on this document. Please contact Debra Carey on 202-208-5542 if you wish to discuss our comments further.

Sincerely,

Daniel L. Fletcher
Associate Director – Financial Statements and Systems
Office of Financial Management

Enclosure A

Exposure Draft, "Accounting for Fiduciary Activities"
Additional Comments

Materiality

Every accounting standard contains language that states, "The provisions of this statement need not be applied to immaterial items." The presence of this statement ensures that if a minor error is found during the course of an audit, the opinion on the financial statements taken as a whole need not be impacted by that minor error. Materiality is a reporting concept subject to a great deal of professional judgment, and the determination of what is material is subject to a number of factors. Further, the determination of what is "material" is being impacted by OMB Circular A-123 and other laws and regulations which specifically expand the concept of materiality to qualitative as well as quantitative factors.

However, from a general ledger perspective, accounting standards are applied equally to all transactions with no consideration given to the size of the transaction. The purchase of a small quantity of office supplies is recorded in the accounting records with the same level of precision as the purchase of assets worth millions of dollars.

At times, standard setters determine that the size or significance of a transaction should be a factor in the application of a standard. This is the case in SFFAS No. 4, paragraph 112, where the significance of a transaction is a factor in determining whether costs should be imputed. If materiality or significance is expected to be a criterion for identification of Fiduciary versus non-fiduciary activity, this criterion must be stated in the text of the standard with appropriate explanation and guidance for the preparer. The boilerplate language in each standard does not communicate to the reader any additional materiality considerations the standard setters expect users to apply. Thus, from the standpoint of general ledger recognition, it is essential that the standards be appropriate for any size transaction unless the text of the standard specifically addresses materiality within the scope of the definition or the reporting requirements.

Appendix C – Examples of Fiduciary Note Disclosure

This example is very detailed and is likely to create confusion. We believe that the sample disclosures should be deleted.

If not deleted, this Appendix should be significantly streamlined, and any examples made generic as was done on page 32 with the use of "Fiduciary Fund A." This will ensure that there is no implication that FASAB has established a level of reporting beyond the content of the standards themselves. The table illustrating "Changes in Non-Valued Fiduciary Assets" includes very detailed examples, for example "kilograms of Cannabis seized." Inclusions of these examples strongly implies agency reporting at this level, although this is well beyond the content of the standards.

Fiduciary Asset Standard General Ledger Accounts, and
Appendix D - Pro Forma Transactions

Fiduciary Fund Balance with Treasury is unnecessary, as is "Fiduciary Investment in Treasury Securities and Non-Treasury Securities. The actual fiduciary entity should be in a separate self-balancing set of accounts, and therefore the use of unique SGL accounts is unnecessary, and will overly complicate the reporting. In addition, as noted below, SGL accounts are beyond the scope of accounting standards. Further, illustration of Standard General Ledger (SGL) accounts and posting models as presented in Appendix D are not appropriate in an accounting standard and should be deleted.

If the Fiduciary activity is so entwined with agency operations that a self-balancing set of accounts is not feasible, then exclusion of those amounts from the agency Balance Sheet is inappropriate.

For example, when the parent entity of the Thrift Savings Plan (TSP) receives money to deposit into the TSP itself, this Federal agency will have normal Fund Balance with Treasury and a liability to the TSP. When the transfer occurs, both Fund Balance with Treasury and the liability are zeroed out. The Federal agency has no need for new SGL accounts to account for this activity.

If transactions are to be illustrated, the entities need to be properly displayed. Any activity which is excluded from a Federal Balance sheet is a different "entity" and requires its own trial balance. Just as the Treasury General Fund is presented as a separate entity from the Federal Component Entity and the Treasury Bureau of Public Debt in Appendix D, the Fiduciary Accounts excluded from the Balance Sheet must likewise be presented as a separate entity. The illustration should not commingle these balances with the Federal agency. This presentation makes the illustration overly complex and difficult to understand and apply.

Thus, if Appendix D is to be retained, a fourth column should be added to Illustration #5 on page 39 to differentiate the Component Entity from the Fiduciary Entity. The illustration becomes much clearer when a distinction is made between the Federal component entity and the fiduciary funds. In addition, it becomes clear that new "Fiduciary" assets accounts such as "Fiduciary Fund Balance with Treasury" are unnecessary.

Format of Footnote Disclosures

We do not concur with disclosure of Fiduciary Net Assets. Rather, we prefer a disclosure consistent with the existing audited Trust Fund Disclosures which present a Balance Sheet type presentation of Assets and Total Trust Fund Balances, accompanied by a flow statements

Initiation of Fiduciary Activity

Paragraph 11 states that "Fiduciary activities are initiated by fiduciary collections." This is incorrect. Fiduciary activities are initiated by a legal trust document or other law or regulation governing the types of activities to be performed by the designated trustee. A fiduciary collection is merely one of many activities that may be performed under the trust agreement.

Disclosure of Non-Valued Fiduciary Assets

Paragraph 16, Part d presents requirements for additional disclosures related to Fiduciary activities. However, this section is unclear as to how extensive the disclosure of non-valued Fiduciary Assets would be. Land held in trust is presented as an example, however, there are many other assets also held in trust, including oil and gas deposits, timber, and other resources. In addition, the management considerations and activities appropriate for seized property and other assets not subject to a trust agreement are different from those appropriate for assets governed by a trust agreement. This requirement needs to be clarified to more clearly communicate the Board's intent regarding each class of asset.

Limitation of the Fiduciary Definition

There are at least two possible approaches to limiting the provisions of this standard to activities that meet a high standard for fiduciary management.

One approach would be to revise the fiduciary activity definition. The definition currently states that for fiduciary activity, non-Federal parties must have an ownership interest in cash or other assets held by the Federal entity and that the ownership interest must be enforceable against the Federal government. This definition could be expanded to state that evidence of a fiduciary relationship would include an absolute certainty of non-federal ownership, periodic statements to account holders, maintenance of self balancing accounting records for the fiduciary activity, and periodic independent audits.

An alternative approach would be to leave the current definition unchanged, and focus on the reporting requirements. Specifically, balance sheet recognition of an asset and offsetting liability would be required unless specific criteria are met. These criteria would include the same factors noted above: an absolute certainty of non-Federal ownership; periodic statements to account holders; maintenance of self balancing accounting records for the fiduciary activity; and periodic independent audits.

Enclosure B

Request for Comments

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

We believe that the definition is in fact too broad, and sweeps in activity for which the reporting requirements of this standard would not be appropriate. For example, certain deposit funds, escrow-type accounts related to oil and gas lease sales, and other miscellaneous activity may become fiduciary. Continued Balance Sheet recognition of these collections would ensure an appropriate level of accounting control.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

No. The exclusion of payroll withholdings and garnishments should apply to all short-term, pass-through activity, regardless of whether that activity is payroll related. See response to Question 3 below.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

We concur that payroll withholdings and garnishments should be excluded from the Fiduciary Activity reporting requirements. However, we believe that this exclusion is conceptually based, and should not be presented as an exception. In other words, the definition of "fiduciary" should be such that this type of short-term, pass-through activity is excluded from the fiduciary concept regardless of whether the activity is payroll related.

For example, in the course of collecting Federal revenues, a DOI bureau may collect small amounts of money which belong to state or local governments. These collections are a byproduct of Federal collection activity and are not distinguishable from Federal dollars at the time of collection. Since these transactions occur in the normal course of business as a by-product of Federal revenue collection activities, the funds are held for the shortest amount of time possible. Interior does not prepare statements of account for this activity. These amounts should be recognized as an asset and liability until the funds are disbursed to the owners. Any attempt to remove these amounts from the balance sheet or physically separate the assets would require an extraordinary amount of accounting effort while reducing general ledger control over the activity. Conceptually, this activity is nearly identical to payroll withholdings. The same treatment would be appropriate.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

We concur that unearned revenue should be excluded from the fiduciary reporting requirements. As with payroll withholdings above, we believe that this exclusion is conceptually based and should not be regarded as an exception.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

While we agree with the note disclosure requirement, we do not agree with the basis of accounting required in presenting the information. The financial treatment of fiduciary assets and liabilities should correspond to the generally accepted accounting principles applied to investment accounts managed by private sector firms. Specifically, revenues earned by investors are not credited to an individual's account until that revenue is received by the investment management company, particularly when the amount of such revenue is variable, e.g. mineral royalties or timber cutting fees.

The information in the Note should be as clear as possible to the reader. If receivables and payables for Trust activity are included in the Schedule of Fiduciary Activity and the Schedule of Fiduciary Net Assets, readers, including beneficiaries of the Trust, may be misled into believing that they have more assets at their disposal than is actually available for disbursement. For example, income earned on Trust land or other Trust assets cannot be accumulated into a beneficiary's Trust account or disbursed until constructively received and collectibility is assured. The Trustee can not and does not maintain a cash balance to support this disbursement, as use of assets of one beneficiary to cover the account of another beneficiary would be a breach of the fiduciary responsibility. The footnote should report the same amounts that are reported by the Trustee in periodic statements to beneficiaries and in annual audited financial reports.

In addition, we do not believe that "Net Assets" is an appropriate bottom line for this disclosure. Rather, the disclosure should be made in the balance sheet format, with a presentation of Total Assets and Total Trust Fund Balances, accompanied by a flow statement presenting Changes in Trust Fund Balances. See the Indian Trust Fund example attached.

We do not agree that Fund Balance with Treasury, or any other asset account, should be broken out to separately report deposit fund balances or any other amount included in the Fiduciary Activity definition. The three true fiduciary activities, the Thrift Savings Plan and the Individual and Tribal Indian Trust Funds, currently maintain independent, self-balancing sets of accounts. Many of the assets associated with deposit-fund-type activities included in the Fiduciary definition are properly combined with Federal assets in the normal course of business. The amounts due to non-Federal parties are identified by appropriate liability accounts. Attempting to differentiate the underlying asset balances between fiduciary and non-fiduciary is inappropriate and serves no useful purpose.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

No. A particular Fiduciary activity, such as Indian Trust, should be consolidated and reported in total by the component entity with the program responsibility. Piecemeal reporting by different reporting entities would be unclear and confusing.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government?

No. If a fiduciary activity is important enough to show in a component entity's footnote disclosure, then we believe that it is important enough to show as a non-aggregated line item in the footnote disclosure of the Financial Report o the U.S. Government.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, Identifying and Reporting Earmarked Funds, addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

Yes. However, as noted above, we believe that the majority of these collections should remain as assets and liabilities on the balance sheet.

Also, the previous custodial activity guidance never clearly defined the term "custodial" and was unclear regarding whether a Federal agency could have custodial activity due to the public. Paragraph 52 of the Basis for Conclusions presents a definition of custodial that clearly indicates that custodial activity represents "amounts collected by one Federal component entity on behalf of another Federal component entity…" This definition should be brought into the text of an accounting standard.

Regarding the proposed changes to paragraphs142 and 276 of SFFAS #7, it should be noted that in nearly all cases, the royalty collections distributed to state and local governments are federal funds distributed according to Congressional direction. These funds are Federal dollars from the sale of Federal resources. As a policy decision, the Federal government shares a portion of these receipts with state and local governments, however, the state and local governments have no underlying ownership interest in the collections.

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

Yes. However, we believe that early implementation should be permitted.

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

In theory, we do not believe that a stand-alone statement is necessary to enhance visibility or audit coverage. In most Federal audits, the footnotes are given the same level of audit scrutiny as the financial statements.

However, we agree with underlying concern addressed by this Alternative View. In our opinion, a self-balancing set of accounts, a complete set of financial statements and an accompanying independent audit are indicators of proper management of fiduciary activity. Thus, only activity subjected to full audit scrutiny would be treated as fiduciary. The Federal agency's financial report would present summarized information in footnote form of data audited elsewhere.

Any Federal receipts or balances which are not a result of a documented fiduciary arrangement and which are not accompanied by this level of accountability should remain on the balance sheet of the Federal agency, and should be reported as an asset and offsetting liability.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

We agree that the Government-wide reporting treatment should be consistent with individual agency reporting. However, as stated above, the fiduciary activity definition should be significantly tightened.

U.S. Department of Justice

Justice Management Division

Finance Staff

Washington, D.C. 20530

AUG 30 2005

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Comes:

In response to your request dated June 27, 2005, we have reviewed the revised Exposure Draft of a proposed Statement of Federal Financial Accounting Standards entitled, *Accounting for Fiduciary Activities*. We thank you for having the opportunity to comment on this document. Department of Justice comments on the Exposure Draft are enclosed. Enclosure A includes our general comments pertaining to the Department's Asset Forfeiture Fund. Enclosure B includes responses to the request for comments on seized property.

We look forward to discussing this with you further. Please contact Lori J. Armold, Assistant Director, Financial Policies and Requirements Group on (202) 616-5216, if you have any questions.

Sincerely,

Melinda B. Morgan

Melinda B. Morgan
Director

Enclosures

cc: Marilyn A. Kessinger, OIG

Enclosure A

Department of Justice - General Comments

1. We believe the Board has not fully taken into consideration the unique nature of federal statutes and case law pertaining to *seizures for forfeiture* or the unintended consequences should the proposal be applied to seizure reporting at the component level. An additional exclusion for seized monetary instruments would meet the Federal financial reporting objectives set forth in the Executive Summary without adversely affecting the reporting for seized monetary instruments at the Assets Forfeiture Fund/Seized Asset Deposit Fund (AFF/SADF) level. We recognize, however, that the complexity of this narrow yet important area may warrant deferring a decision on sections dealing with seized monetary instruments until all concerned can garner a more thorough and accurate understanding of the implications.

2. In paragraph 10, the definition of fiduciary activity is described where "... a Federal entity collects or receives and subsequently manages, protects, accounts for, invests, and/or disposes of cash or other assets in which non-Federal individuals or entities (or "non-Federal parties") have an ownership interest that the Federal Government must uphold". In our view seizure has important Constitutional and law enforcement elements that set it apart from routine collecting or receiving monies for which there may or may not be contractual consideration or taxing authority. Under law, private ownership rights are extinguished upon violation of certain statutes. At seizure the Government is asserting a superior legal right to the property. This superior right is inchoate until the Government observes due process and other Constitutional protections while enforcing the forfeiture laws, and that right is established as a matter of law. At that time, the Government's legal right dates back to the date of the offense that gave rise to the forfeiture. Thus, we do not believe the substance of *seizure for forfeiture* meets the proposed definition of fiduciary activity.

3. Similarly, paragraph 29 of the Exposure Draft, proposes to amend paragraph 31 of SFFAS 1 relative to fiduciary or other non-Federal non-entity fund balance with the Treasury and reads in part as follows:

   "... From the reporting entity's perspective, the reporting entity's fund balance with Treasury FBWT is an asset because it represents the entity's claim to the federal government's resources. However, from the perspective of the Federal Government as a whole, it is not an asset; and while it represents a commitment to make resources available to federal departments, agencies, programs and other entities, it is not a liability."

   Further, the basis for this position in paragraph 47, states that the Board considered whether recognizing fiduciary assets on the balance sheet might imply not only

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managerial control over the assets, but also that the benefit of the assets accrue to the federal component entity. The Board decided that fiduciary assets should not be recognized on the balance sheet of the federal component entity because they are not assets of either the federal component entity or the Federal Government as a whole.

Both paragraph 29 and paragraph 47 do not sufficiently take into account that: i) the government has an asserted legal interest, ii) the government has managerial control over seizure receipts and iii) related interest benefits do accrue to the federal component entity. Moreover, we strongly believe public opinion and the appropriate generally accepted accounting principles should be a guide in this area since there is such an integral connection to the concurrent rights of individuals from whom property is seized. We believe that public sentiment, federal Courts and the concepts embedded in private sector accounting principles all gravitate toward requiring seizure receipts to be recorded on the balance sheet with an offsetting deferred credit.

4. Among other benefits of the proposed standard, the Board also addresses Objectives #2 and #3, Statement of Federal Financial Accounting Concepts 1, *Objectives of Federal Financial Reporting* by noting the following:

Objective #2 – Federal financial reporting should assist report users in evaluating the service efforts, costs, and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.

Objective #3 – Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future.

Contrary to the proposal, we believe there are several characteristics of seizure management and forfeiture funding statutes that converge to form unique user information needs requiring seized monetary instruments to be reported in stand alone statements at the component level for precisely the reasons described in Objective #2 and #3.

Enclosure B

Department of Justice - Request for Comments

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

We agree the definition in paragraph 10 covers all fiduciary activity relating to the Department of Justice Assets Forfeiture Fund/Seized Asset Deposit Fund (AFF/SADF) as a financial reporting entity but we have no basis for evaluating whether that definition covers all potential fiduciary activity in which the AFF/SADF or other Federal entities might engage in the future.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

We agree that the description of payroll withholding and garnishments in the proposed standard is adequate.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

We agree that payroll withholding and garnishments should be excluded from the fiduciary reporting requirements and, for reasons set forth herein, recommend additional exclusions for the receipt of seized cash, proceeds from pre-forfeiture sales of seized property, cost bonds, and income from property under seizure.

Irrespective of the ultimate treatment adopted at the consolidated FR level, we believe the special powers, duties and legal obligations surrounding the seized for forfeiture process necessitate that seized monetary instruments be reflected on the balance sheet of components responsible for seized for forfeiture reporting. As proposed, the requirements would remove seizure receipts from the face of the stand-alone audited financial statements for the AFF/SADF. Yet under paragraph 23 the liability for fiduciary investments in Treasury securities (which we interpret to include invested seizure receipts) should be recognized on the Government-wide balance sheet as debt held by the public. In our view this inconsistency would be eliminated by an additional exclusion for seizure receipts without detracting from other areas where the proposal contributes to meeting Federal financial reporting objectives.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

We agree that unearned revenue should be excluded from the fiduciary reporting requirements.

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Because seizure receipts share many similarities with unearned revenue, we recommend additional exclusions for the receipt of seized cash, proceeds from pre-forfeiture sales of seized property, cost bonds and income from property under seizure. Although ownership becomes a tenuous legal concept upon the inception of a seizure, typically over 90 percent of seized monetary instruments are forfeited and make up 60 percent or more of total forfeiture income. We believe the accounting substance dictates that the rights of individuals from whom property is seized be recognized concurrent with the Government's interests. Since the program's inception, seizure receipts have been recorded on the balance sheet with an offsetting deferred credit that essentially serves as a liability for any portion that is ultimately returned and unearned revenue for the forfeited portion. This practice has withstood the test of time with the public, the federal Courts and it is consistent with the concepts embedded in private sector accounting principles.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

We disagree with the proposal to report monetary instruments *seized for forfeiture* only in a footnote to Agency's financial statements primarily because to do so would reverse improvements that have brought federal financial reporting closer to the levels of relevance and accountability targeted for general purpose financial statements in the private sector.

As a single important example of how the Exposure Draft is a step backward, the proposal would amend paragraph 26 of SFFAS 1 Accounting for Selected Assets and Liabilities that currently reads:

Both entity assets and non-entity assets under an entity's custody or management should be reported in the entity's financial statements.

This provision as promulgated has the effect of putting the AFF/SADF financial statements on an equivalent basis with those of banks and other entities following generally accepted accounting principles. Accounting rules require cash and corresponding liabilities for bank customer deposits to be displayed on the balance sheet even though the money deposited does not belong to the bank issuing the statements. The proposed amendments would remove seized monetary instruments from government balance sheets thereby impairing the relevance of the Department of Justice (DOJ) AFF/SADF statements in order to clear up what is essentially a consolidation bookkeeping matter.

The logic holding that seized monetary instruments do not belong to the government and therefore do not belong on the balance sheet does not recognize that the government does has a significant though inchoate legal interest. Additionally, the logic is not reasonable relative to standards applied in general commerce for a wide range of enterprises including banks, utilities, leasing corporations, not-for-profit organizations, mortgage banks, partnerships, publishers and state and local governments. The practices of these private sector entities take on particular relevance given the nature of concurrent public and private interests in monetary seizures.

In that light, the proposal that seized monetary instruments should differ in treatment from payroll withholdings or unearned revenue and that SADF investments in Treasury securities should be recognized solely on the Government-wide balance sheet as debt held by the public (per paragraph 23) is difficult to rationalize.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

We disagree with the proposal to report seized cash, proceeds from pre-forfeiture sales of seized property, cost bonds and income from property under seizure as fiduciary activities only in a footnote to the DOJ AFF/SADF financial statements. We also disagree with the requirement in paragraph 17 that reads:

> *"If more than one Federal component entity is responsible for administering a fiduciary activity, and the separate portions of the activity can be clearly identified with a responsible component entity, then each component entity should disclose its portion in accordance with the requirements of this standard. If separate portions cannot be identified, the component entity with program management responsibility should disclose the fiduciary activity."*

We support a concept similar to that embodied in *Accounting for Inventory and Other Related Property,* SFFAS No. 3, whereby seized property financial records are maintained and reported by a "central fund" created to support the seizure activities of one or more Federal agencies. For cost benefit and accountability reasons, the DOJ would not want to report separate fiduciary activity beyond the AFF/SADF where separate portions of fiduciary activity can be clearly identified.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government?

We disagree with the proposal to report fiduciary activities only in a footnote to Agency financial statements for the reasons stated herein and we believe fiduciary note disclosure in the Financial Report of the U.S. Government for "component entities with immaterial amounts of fiduciary net assets" could unnecessarily detract from the readability of the statements.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

We agree that the proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections".

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

If seized monetary instruments, SADF Investments and related seizure receipts are to be removed from the financial statements and reported as a footnote only, the implementation date may not be appropriate for the DOJ AFF/SADF. This is especially true if paragraph 17 of the Exposure Draft remains unchanged.

Automated financial management controls and reporting processes govern much of the collection, payment and accrual accounting transaction processing associated with seizure receipts and returns as well as the associated operating costs and any consequential forfeiture income. In a multi-component entity such as the AFF/SADF we cannot quickly or easily convert from the current ledger reporting and management information framework to a system that reverses the most significant transaction cycle the entity has to take that information out of external statements and put it in a footnote at the end of each quarterly reporting period. We are reluctant to agree that the proposal will be as easy to accomplish as simply recording top line elimination entries.

Our existing multiple entity financial and seized property systems must be evaluated and modified to accommodate the proposed reporting in a manner that does not diminish the controls over seized for forfeiture accounting activity or threaten quarterly reporting deadlines. We feel the proposed changes will impact both the cost and timing of implementing the Department of Justices' unified financial management system to a degree that cannot be reasonably estimated until proposal comments are evaluated.

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a stand alone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

We agree with and support the Alternative View on page 23 as a general principle applicable to all fiduciary activities. We believe the proposal has far reaching effect beyond the question of whether fiduciary activity shows up in a footnote or should be reported in a stand alone financial statement subject to full audit scrutiny.

In our view the Exposure Draft does not focus reporting on diverse users' needs for information. Removing seized cash and other types of "fiduciary activity" from the applicable balance sheets of the Federal Government does nothing to broaden the focus to the wider array of information necessary to promote accountability or provide useful information that is understandable, well organized and consistent with other methods of reporting important financial information that are now generally familiar to a financially sophisticated public.

The Exposure Draft narrowly re-defines assets and liabilities to exclude monetary seizures. This definition loses the benefit of the accounting treatment that has been applied since the inception of AFF/SADF reporting. These longstanding rules are based in part on the fact that in *seizures for forfeiture* the government has obtained a probable future economic benefit and most certainly has legal liability for the return of any seizure receipts for which forfeiture is denied. Under various statutes and court opinions the government may also bear responsibility for paying out imputed interest on any seized monetary instruments or cost bonds that are returned.

While we understand and support the broader objectives of the Exposure Draft, the serious responsibilities surrounding statutes that authorize the seizure of property require a level of transparency, stewardship and due process. Governmental seizure activity requires balancing public policy and law enforcement objectives with the need to protect the rights of individuals. In our view, Federal managers, Congress, the Courts and the public can only have insight into the activities and controls necessary to guard against mistakes or inappropriate delays in seizing and taking ownership of private property from citizens when full scope, general purpose financial reporting is provided. Accordingly, the reporting standard at the component level should be no less than those for federally insured financial institutions that, by law, must record monetary deposits as both assets and liabilities.

Seized monetary instruments differ in other important ways from the property seizures for which footnote disclosure alone is generally considered sufficient. Money is fungible and requires additional internal control procedures to assure adequate safekeeping, and segregation of duties along with audit trails to facilitate detailed accounting even when moneys are commingled in government cash or investment accounts. The DOJ has been called to testify before various courts as to the accounting for seizure receipts. We do not believe footnote disclosure alone portrays the appropriate duty of care.

Removing seized monetary instruments from the statements of the AFF/SADF also renders the statements far less meaningful from a management information and decision-making standpoint. Typically, over 90 percent of seized cash is forfeited, comprising roughly 60 percent of total forfeiture income. By statute the underlying forfeiture income, including in certain circumstances interest earned on SADF receipts, supports prescribed federal, state and local law enforcement activities. Footnote disclosure alone will not be sufficiently informative and will not meet the objective of representational faithfulness required to present the true import of seized monetary instruments on this important law enforcement mission.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

Our paramount concern is with the impact of the Exposure Draft on the DOJ AFF/SADF stand alone financial statements, however, we are in general agreement with the Alternative View beginning on page 26.

U.S. Department of Justice

Office of the Inspector General

Washington, D.C. 20530

August 30, 2005

Wendy Comes, Executive Director
Federal Accounting Standards Advisory Board
Mail Stop 6K17V
441 G Street, NW – Suite 6814
Washington, DC 20548

Dear Ms. Comes:

The Financial Statement Audit Office of the Department of Justice's Office of the Inspector General appreciates the opportunity to provide comments on the Federal Accounting Standards Board's (FASAB) Revised Exposure Draft Accounting for Fiduciary Activities, dated June 27, 2005.

Please see the Enclosure for our response to the specific questions raised in the Exposure Draft. Thank you again for the opportunity to comment on this document. Please contact me at 202-616-4523 if you wish to discuss our comments further.

Sincerely,

Mark L. Hayes
Assistant Director

Enclosure

Enclosure

Responses to Request for Comments – Page 6 of Revised ED

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

   Yes, we believe the definition encompasses all potential fiduciary activity.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

   The descriptions are adequate.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

   Yes, we agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

   Yes, we agree that unearned revenue should be excluded from the fiduciary reporting requirements.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

   Yes, except as discussed in Nos. 7 and 11.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

   Do you mean paragraph 18? With respect to paragraph 18, yes, we agree there should be separate reporting of individual fiduciary activities and total fiduciary activity.

1

7. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

   Do you mean paragraph 18? With respect to paragraph 18, yes, we agree there should be separate reporting of individual fiduciary activities and total fiduciary activity.

8. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government (FR)?

   Yes, immaterial amounts of fiduciary net assets should be aggregated at the FR level. However, those component entities with individually significant fiduciary net assets (to the FR) should be disclosed separately (i.e., not aggregated) in the FR.

9. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

   Yes, we believe the proposed standard addresses the same activities.

10. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

    Yes.

11. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

    His point has merit; however, we believe a note disclosure would be sufficient.

12. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

    Yes, we believe the reporting requirements should be consistent for both the FR and the component entities.

Additional Specific Comments

1. Paragraph 28, revision to SFFAS 1, paragraph 29(a): All non-entity assets, including cash, are not reported on the Balance Sheet (except as aggregated with entity assets) but disclosed in a note to the financial statements, per OMB Circular A-136.

2. Paragraph 30, revision to SFFAS1, paragraph 38, new paragraph: The last sentence says, "For disclosure requirements for fiduciary FBWT, See SFFAS___, *Fiduciary Activities.*" Where exactly are these disclosure requirements for fiduciary FBWT? Are you referring to paragraph 16(c)? This requirement needs clarification in the Fiduciary Activities proposed standard.

3. The title of the proposed standard is: *Accounting for Fiduciary Activities.* Ensure consistent usage throughout the document.

Attachment 1: Written comments and oral presentations received: 11 LOC OIG

UNITED STATES GOVERNMENT LIBRARY OF CONGRESS

Memorandum ***Office of the Inspector General***

TO: Wendy M. Comes August 30, 2005
Executive Director
Federal Accounting Standards Advisory Board

FROM: Nicholas G. Christopher
Assistant Inspector General
Library of Congress

SUBJECT: Comments on Revised Exposure Draft: Accounting for Fiduciary Activities

This is a reply to the Federal Accounting Standards Advisory Board regarding the above exposure draft dated June 27, 2005. This reply summarizes concerns expressed by the following interested parties:

- Office of the Chief Financial Officer, Library of Congress
- Office of the Inspector General, Library of Congress
- Kearney & Company (Certified Public Accountants)

Our review of the exposure draft causes us concern that its implementation will result in less clarity to financial statement users. We believe it will result in diminishing full disclosure to financial statement users by fragmenting the presentation of agency liabilities and related fiduciary assets. We have the following general concerns:

1. Billions of dollars of liabilities will be moved off of the "Federal Books." The Board should examine the practices of entities having similar fiduciary transactions including banks and other financial institutions, real estate companies, pension plans, and law firms (e.g. escrow funds). These institutions present the results of fiduciary activities in their primary financial statements.

Federal financial accounting for fiduciary activities should be in harmony with the above organizations. This harmony will assist users of Federal financial statements in understanding the financial statements. Disparate treatment will only complicate user understanding and analysis.

What is currently being recommended is synonymous with a bank removing from its balance sheet the assets and liabilities related to depositor accounts while at the same time absorbing the costs of handling, protecting and tracking those funds. Such an approach would inhibit the understanding and analysis of operating activity.

2. Fiduciary activities of the Federal government may not always be financed by government funds, but the activities are certainly a function performed by the Federal government. Fiduciary functions are a cost of doing Federal business and these costs and related accountability should be reflected in the body of the primary financial statements.

3. Removing fiduciary assets and related liabilities from the balance sheet fails to fairly state an Agency's exposure/liability for fiduciary activity. Footnote disclosure may reduce the significance of the liability as well as complicating the recognition of the liability. Additionally, ratio analysis could be significantly affected.

In addition to our general comments we have the following specific concerns for the Library of Congress:

- One complication of removing fiduciary balances off the Balance Sheet is we reconcile investment activity with the Bureau of Public Debt (BPD) and Fund Balance With Treasury (FBWT). The Standard General Ledger Board is already deliberating on new Standard General Ledger (SGL) accounts needed to separate posting and reporting for Fiduciary FBWT and investments. While separate SGL accounts may help with reporting and reconciliation requirements, it does illustrate the added complication this treatment of fiduciary activity will cause Agencies.

- Another concern would be for investment accounting and inter-governmental elimination reconciliation with the BPD. Would BPD be paying investment interest to the Library of Congress as a Federal Trading Partner, or would the fiduciary recipient account be considered non-Federal? If the Library records interest income from BPD as the Federal Trading Partner this would not be eliminated if BPD were paying interest to a nonfederal fiduciary account. This may require more SGL accounts for investment activity.

- Does fiduciary activity by definition mean that it must be "outside" the Budget? If it can be included in the Budget, than fiduciary activity should also be removed from the Statement of Budgetary Resources and included in either the fiduciary activity footnote or principal financial statements (whichever is adopted).

  If this proposed standard is adopted, it would impact the library's Copyright Licensing's Payment to Copyright Owners Special Fund (approximate asset value of $800 million). Currently this fund is included in the Budget. However, upon reviewing the Board's definition of Fiduciary activity, as well as past guidance on Earmarked Funds and OMB decisions on what kind of activity should be included in the Budget, it is our opinion that Copyright Licensing activity is fiduciary, not earmarked activity. We also feel it should be removed from the Budget and its treasury symbol be changed from a special fund to a deposit fund account symbol. We will be consulting with OMB to determine if this fund reclassification can be made.

However, if Copyright Licensing Royalty Receipts and Distributions continue to be included "in the Budget" then it should remain on the balance sheet and statement of budgetary resources to reflect the source of Federal Receipts and Outlays. If budgetary fiduciary activity is removed from the balance sheet it should also be removed from the Statement of Budgetary Resources. However, this would lead to confusion comparing Agency Financial Statements to the Presidents Budget figures, the SF 133 Report on Budget Execution and Budgetary Resources and the Program and Financing Schedule. Which leads back to the need for the Fiduciary standard to define Fiduciary activity as only for funds excluded from the Budget or if can be included, discuss the affect on Budgetary reporting which is covered in other FASAB standards as well as OMB and Treasury guidance.

- In the exposure draft there is mention of Non-Entity/Non-Fiduciary assets that would remain on the Agency's balance sheet. As an alternative to removing Fiduciary Activity from the Balance sheet, could note 2 of OMB 01-09 be revised to require separate disclosure of Non-Entity/Non-Fiduciary and Non-Entity/Fiduciary assets?

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

August 31, 2005

Wendy M. Comes, Executive Director
Federal Accounting Standards Advisory Board
Mailstop 6K17V
441 G Street, NW, Suite 6814
Washington, DC 20548

Dear Ms. Comes:

Thank you for the opportunity to provide comments on the June 27, 2005 exposure draft of "***Accounting for Fiduciary Activities.***" We think that overall the proposed standard provides excellent clarification on a lot of issues and will improve financial reporting in this area. We are providing the following specific comments for your consideration.

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

    - Yes, we agree with this definition. We believe the definition is accurate and the characteristics spell out what is necessary to distinguish a true fiduciary activity from the many so-called federal "trust fund" activities that are not trust funds in the typical sense. We also would propose that the standard call for a harmonization of the titles assigned to fund account symbols with generally accepted accounting principles for the Federal Government. In addition, we believe that any further clarification that will clearly distinguish between "fiduciary activities", "earmarked funds", and "trust funds", would enhance understanding, perhaps in the glossary.

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

    - Yes, we agree with this description.

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

    - Yes, we agree with that payroll withholding and garnishment should be excluded from the fiduciary reporting requirements.

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

- Yes, we agree that unearned revenue should be excluded from the fiduciary reporting requirements. However we believe that there needs to be a more comprehensive definition of the terms “Unearned Revenue”, “prepayments”, and “advances” in regards to paragraph 13 and the definition of “Unearned Revenue” in Appendix B Glossary. We agree with the August 17, 2005 testimony of Mr. Gaddy in regards to clarification of these terms.

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? (See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government.) (See paragraphs 35-58 in the Basis for Conclusions for the rationale.)

   - No, we do not believe that it is an appropriate reporting treatment to report fiduciary assets and liabilities, in the footnotes to the financial statements and not on the face of the statement. **We recommend reporting fiduciary assets and liabilities on the Balance Sheet**, in the asset section of the balance sheet that there be a line specifically for fiduciary assets, and in the liability section a line for fiduciary liabilities. Further detail to these individual accounts would be provided in the notes, depending on the materiality.

   - No, we do not believe that it is an appropriate reporting treatment to report the inflows and outflows of fiduciary activities, in the footnotes to the financial statements and not on the face of the statement. **We recommend that current inflows and outflows of fiduciary activities be shown on the face of the Statement of Custodial Activity**. Minor adjustments to the format of the statement of Custodial Activity would be required. The format is very similar to the proposed format for the footnote disclosure, as well as the format of the dissenting board member suggesting a new stand alone statement. The Statement of Custodial Activity could be designed in a method to separate fiduciary activity from typical custodial activity, yet include them both on the same statement.

   - We believe that current disclosure requirements are already too extensive. This type of note would not easily lend itself to automation at a time when Federal agencies are striving to accelerate their reporting. Having actual posting trial balance accounts flow to a footnote disclosure and not to the face of the financial statement would tend to confuse the consolidation process at the Department and Government-Wide level. Automation of footnotes is already a difficult process and this requirement would make it more difficult.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activity? If you do not agree, what display would you recommend?

- Yes, we agree with this requirement.

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U. S. Government?

   - Yes, we agree with that immaterial amounts of fiduciary net assets should be aggregated, however rather than a note disclosure they should be shown on the face of the balance sheet.

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (See paragraph 32 of the Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

   - Yes, we agree that this seems to address all the activities formerly classified as “dedicated collections” However we feel that both fiduciary and earmarked funds should be identified with an attribute so that they can be easily identified and accounted for. We believe that mapping fiduciary activities to a note disclosure would further hamper this effort.

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

   - No, we do not agree with the implementation date (unless our approach in response to question no 5 is followed, that is to map to fiduciary activity & balances to the face of the financial statements rather than the notes). With the standard mapping fiduciary trial balance accounts to footnote disclosure, rather than the face of the financial statements, we believe that our bureaus would need more time and investment to adjust their core financial systems. We do not believe that most COTS financial software could adequately support this. We also believe that modifications will need to be made to the standard general ledger.

   - In addition, it is our position that Treasury /General Fund of the Treasury entity reporting clarifications need to be made before this standard can be implemented (See “Additional Comments on the Treasury Reporting Entity”).

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. The member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23.)

- No, we do not agree that there needs to be a standalone financial statement. As previously described we believe that the assets and liabilities should be reported on the balance sheet and the inflow & outflow activity reported on a revised statement of custodial activity. We reviewed the Board's reasoning for not including it on the Statement of Custodial Activity (SOCA - par. 52 -53) but we believe that this does not preclude modification of the SOCA (e.g., Statement of Custodial and Fiduciary Activity).

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

    - We believe that consistency is important to facilitate the consolidation process at the Departmental and Government-wide levels. Therefore, we agree with this Board member. This is another reason why fiduciary activity should be reported on the face of the statements rather than as a disclosure.

Additional Comments:

Treasury Reporting Entity and the General Fund of the Treasury Reporting Entity

Throughout the ED there are references to the U.S. Treasury, the Treasury, Fiduciary Fund Balance with Treasury, Treasury Securities, Treasury General Fund Entity, etc. However, it is not clear what FASAB envisions "Treasury" to be as a reporting entity and its relationship to the Treasury General Fund Entity (accounting entries illustrated in Appendix 5).

In 1998, after months of discussions with GAO, OMB and FASAB staff the Department of the Treasury defined a reporting entity. This presentation was approved by the OMB (see attached). It was agreed that the Department of the Treasury reporting entity did not include the General Fund of the Treasury as a component (note Due from the General Fund and Fund Balance with Treasury as assets on the Department's consolidated balance sheet). Accordingly, the Treasury General Fund Entity shown in the ED does not currently exist.

We do not believe that this proposed standard can be implemented without resolution of the General Fund of the Treasury entity issue. This ED demonstrates the possible need for a separate standard addressing accounting for the General Fund of the Treasury. While we have been advised by the FASAB staff that it does not define reporting entities, we believe that the General Fund of the Treasury is an exceptional situation that affects accounting at all levels of Federal Government reporting.

We also wish to note that the Bureau of Public Debt (BPD) does not have FBWT at year-end resulting from the issuance of securities. BPD deposits the cash collected into Government-wide Cash and recognizes “Due from the General Fund” in conformity with the OMB approved presentation.

Deposit Funds and Investments in Bureau of Public Debt issued Securities

While we support including the assets and liabilities of fiduciary funds on the balance sheet, we have concerns regarding current recording of transactions.

The Bureau of Public Debt records the liabilities for deposit fund investments as liabilities with the public (part of the Federal Debt owed to the public). However, the agencies purchasing the securities record them as intra-governmental investments owed to them by the Bureau of Public Debt. These agencies also report a liability to the public for the investments. We believe this contributes to the FR out-of-balance elimination problem and results in double reporting of liabilities to the public in the FR.

We also note that the ED assumes that revenue earned on fiduciary investments is always owed to the public. This is not the case with invested seized cash. The revenue for these types of fiduciary funds is intra-governmental and should be eliminated for the FR. The accruals should not be displayed as part of interest payable on the Federal Debt owed to the Public.

Again, we appreciate the opportunity to comment on this exposure draft. If we can be of further assistance, please contact Mr. Don Geiger, Office of Financial Systems Integration, on (202) 622-0809 or Joseph McAndrew, Office of Accounting and Internal Control, on (202) 622-0807.

Sincerely,

James R. Lingebach
Acting Deputy Chief Financial Officer

Attachment A

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

AUG 24 1998

Mr. Norwood Jackson
Deputy Controller
Office of Management and Budget
Washington, DC 20503

Dear Mr. Jackson:

I want to thank you for meeting with us to discuss the Department's fiscal year 1998 financial statement presentation. As a result of our meeting, we believe we have a presentation which will be useful and understandable to all readers.

Enclosed is the revised balance sheet. It has been modified to include the public debt liability with the offsetting asset, "Due from the General Fund." Also included on the balance sheet is the Federal Government's cash as well as other assets we manage on behalf of the General Fund.

We appreciate your assistance and the contributions of the Department's financial statement work group in arriving at what we believe to be a practical and informative way of presenting Treasury's "operating entity" and "government wide" financial information.

We would appreciate your concurrence with this approach to presenting the Department's statements, or the need for further discussions, and faxing your response to us on (202) 622-2318. If you or your staff have any questions please have them contact me on (202) 622-0750 or James Lingebach on (202) 622-0818.

Sincerely,

Steven O. App
Deputy Chief Financial Officer

Concur ☐ Let's discuss ☐

Norwood Jackson 8-25-98
Date
Deputy Controller

Enclosure

cc: Gerald Murphy
William Pugh
Gary Engel
Wendy Comes

Department of the Treasury
Balance Sheet
As of September 30, 1997
(In Millions)

ENTITY ASSETS	
Intragovernmental	
Fund Balance	$45,055
Accounts Receivable, Net	72
Loans to Other Federal Agencies	49,853
Investments	16,126
Interest Receivable	1,246
Other	61
Governmental	
Cash, & Other Monetary Assets	21,012
Accounts Receivable, Net	169
Net Assets in the International Monetary Fund	14,045
Investments with International Financial Institutions & with Other Entities	4,868
Investments	3,665
Loans Receivable, Net	2
Inventories and Related Property, Net	445
Property, Plant & Equipment, Net	1,394
Other	60
Total Entity Assets	158,094
NON-ENTITY ASSETS	
Intragovernmental	
Fund Balance	52,544
Due from the General Fund	5,369,033
Advances to the Black Lung Trust Fund	5,487
Loans to Federal Agencies	133,759
Interest Receivable	2,010
Governmental	
Cash	45,264
Gold & Silver Reserves	11,036
Tax/Trade Receivables	28,982
Other Monetary Assets	1,604
Other	34
Total Non-Entity Assets	5,649,753
TOTAL ASSETS	$5,807,847

The Accompanying Notes are Integral Part of These Statements

Department of the Treasury
Balance Sheet
As of September 30, 1997
(In Millions)

LIABILITIES	
Intragovernmental - Covered by Budgetary Resources	
Accounts Payable	272
Interest Payable	1,966
Due to the General Fund and Others	222,896
Debt - Federal Financing Bank	50,151
Personnel, and Other Intra-governmental	155
Governmental - Covered by Budgetary Resources	
Interest Payable	46,052
Seized Assets & Other Non-Entity Assets Held for Others	551
Gold Certificates Issued to Federal Reserve Banks	11,016
Certificates Issued to Federal Reserve Banks	9,200
Allocations of Special Drawing Rights	6,689
Refunds	1,248
Accounts Payable	714
Capital Lease Liabilities	105
Personnel Related Liabilities	413
Deferred Revenue/Deferred Credits	162
Other	75
Total Liabilities - Covered by Budgetary Resources	351,667
Intragovernmental - Not Covered by Budgetary Resources	
Debt, Held by Federal Entities	1,595,674
Interest Payable	26,924
Debt Prepayment Premium FFB	2,201
Personnel, and Other Intra-governmental	171
Governmental - Not Covered by Budgetary Resources	
Debt, Held by the Public	3,744,435
Capital Lease Liabilities	2
Personnel Related Liabilities	1,241
Other	660
Contingencies	73
Total Liabilities - Not Covered by Budgetary Resources	5,373,381
TOTAL LIABILITIES	5,725,048
NET POSITION	$82,799
TOTAL LIABILITIES, & NET POSITION	$5,807,847

The Accompanying Notes are Integral Part of These Statements

Eileen W Parlow - Fw: FASAB Exposure Draft Comments   Page 1

From: <Jim.Sturgill@fms.treas.gov>
To: <parlowe@fasab.gov>
Date: 9/15/2005 3:23:13 PM
Subject: Fw: FASAB Exposure Draft Comments

This is FMS' reponse.

Jim Sturgill, AC GWA

Sent from my FMS BlackBerry Handheld.

These are our comments on the “Accounting for Fiduciary Activities” Exposure Draft

We agree with Mr. Mosso’s alternative view, and his rationale, that component entities should report material fiduciary activity in a stand-alone financial statement that discloses the components of Fiduciary Net Assets and that “notes only” disclosure for immaterial fiduciary activity should not be permitted. Entities that have fiduciary activity that are incidental to their mission should include those activities in their primary financial statements.

To prepare and issue the CFR, FMS uses the agencies’ audited financial statements as the basis for the consolidation. When certain collection activity is permitted to be excluded from component entities’ principal financial statements, this leads to increased difficulty for FMS to correctly obtain and record this collection activity, whether it is a custodial or fiduciary activity. Therefore, by requiring a stand-alone principal financial statement, FMS can compile and report the fiduciary activity of the federal government with greater assurance as to its completeness and validity.

To illustrate this concern, SFFAC 2, par. 103 states;

> Organizations that collect custodial revenues that are incidental to their primary mission do not need to report the collections and disposition of these revenues in a separate statement. The disclosure of the sources and amounts of the collections and the amounts distributed to others could be disclosed in accompanying footnotes.

In implementing this concept, several entities with “incidental” activity have also made the determination that these collections amounts are not significant to warrant a separate note disclosure. The results for the CFR are unreported collection contributing to an annual out-of-balance amount ranging from $3 billion to $21 billion.

FMS agrees that removing certain collection activities (fiduciary and custodial) from an entity’s primary statements may facilitate a better understanding of an entity’s primary mission. But these activities need to be reported consistently, and with the sufficient detail, for FMS to prepare (and for GAO to audit) the CFR. We prefer material activity to be reported in a stand-alone statement.

September 6, 2005

Ms. Wendy Comes, Executive Director
Federal Accounting Standards Advisory Board
Suite 6814
441 G Street NW
Washington DC 20548

Dear Wendy,

Please forgive my tardiness on providing comments for *Accounting for Fiduciary Activities.* I read the Exposure Draft at the beach, but did not want to get sand in my laptop. Hence I had to wait until my return to D. C. to put them to paper.

I think the Board and staff have done a good job with the Exposure Draft. Based on my experience to date, I agree with the definition of fiduciary activities (question 1). I agree with the exclusion of payroll withholdings and unearned revenues (questions 3 and 4). The other matters I wish to address are as follows.

I have a problem considering the Thrift Savings Plan as a fiduciary fund (paragraph 2). How is it different than other benefit plans that Federal agencies and Federal employees contribute to in order that the employees can obtain benefits, e. g., Blue Cross? Is the TSP managed by Federal employees? What agency would consider the TSP one of its fiduciary activities?

Will the paragraph 5 requirement that Federal entities disclose fiduciary assets, liabilities, and flows in a footnote cause problems? Footnotes are subject to audit. What would be the effect on the opinion an agency receives on its financial statements if the fiduciary assets, liabilities, and flows are audited, or if audited, receive a disclaimer or adverse opinion?

I have a problem with paragraph 28. Although SFFAS 1 required that the entity and non-entity assets be reported on the Balance Sheet, in a subsequent Form and Content bulletin, OMB permitted disclosure of the amounts of entity and non-entity assets in a footnote. This has seemed to provide adequate disclosure. Paragraph 28 returns to the requirement that the amounts of entity assets and non-entity assets be reported on the Balance Sheet.

I also see a problem with the paragraph 28requirement that an amount equal to the non-entity assets recognized on the Balance Sheet be recognized as a liability due to Treasury or other entities. It is my understanding that not all non-entity assets result from custodial collections that must be turned over to the Treasury or other entities. Some non-entity assets are offsetting collections which cannot be expended by the agency until Congress provides spending authority. In those cases, there would not be a liability to Treasury or other entities.

I also cannot understand why seized monetary assets should no longer be recognized on the Balance Sheet, but instead disclosed in a footnote (paragraph 31). The fiduciary responsibility for seized monetary assets has not changed, so why should the accounting standard change. The rationale for reporting the asset and liability on the Balance Sheet was to establish control for a highly sensitive, easily valued asset. That need is no less today than it was when SFFAS 3 was issued.

I notice paragraph amends paragraph 102 of SFFAC 2. Adding the phrase "should be reported in accordance with the provisions of SFFAS __ *Accounting for Fiduciary Activities*" could be confusing. Some might interpret that phrase to require that deposit funds and withholdings be recorded as fiduciary funds. The existing wording states exactly what is wanted and should be retained. A better reference to SFFAS __ *Accounting for Fiduciary Activities* would be to replace the words "should be reported in accordance with" with the words "as provided for in."

That's it for now. Now I will get to providing comments on the Objectives project.

Sincerely yours,

Hal Steinberg

Statement of Federal Financial Accounting Standards
Accounting for Fiduciary Activities
Revised Exposure Draft

August 17, 2005

Testimony of: Mr. Zack Gaddy
Director,
Defense Finance and Accounting Service

The Department of Defense (DoD) and I thank you for the opportunity to address the Federal Accounting Standards Advisory Board regarding the revised exposure draft, "Accounting for Fiduciary Activities." This has been a nebulous area of accounting in the Federal government and the Department welcomes FASAB guidance that we can employ in order to provide accurate and consistent accounting treatment of our fiduciary activities.

I want to discuss two concerns the DOD has regarding the revised Exposure Draft. The first concern involves the fact that under the revised Exposure Draft funds can meet the definition of fiduciary activity but those funds can be excluded from being reported as fiduciary activity by paragraph 13 (unearned revenue exclusion). The second concern is that of the inclusion of appropriated funds deposited in the Federal Reserve Bank interest bearing account or the FMS Trust Fund under the authority of the Arms Export Control Act.

Our first concern addresses paragraph 10, which is the definition of fiduciary activity and the applicability of the Foreign Military Sales Trust Fund. In concurrence with our testimony from October 8, 2003, the FMS Trust Fund qualifies on all three points as a fiduciary account. The foreign governments participate in the FMS program and have an ownership interest in cash held in the Foreign Military Sales Trust Fund managed by DOD. The foreign governments can enforce their ownership interest in the World Court for breach of fiduciary obligation.

The Department of Defense seeks clarification on the intent of the unearned revenue exclusion provided in paragraph 13, and its specific applicability in the context of the Foreign Military Sales program administered by the DOD. It appears the intent of the Board is to address all dedicated collections as either fiduciary activity in this revised Exposure Draft or as earmarked funds under Standard 27, Identifying and Reporting Earmarked Funds. If the FMS Trust Fund would be excluded from being fiduciary under paragraph 13 then we would assume it would be the Board's intent that Standard 27 would apply. However, Standard 27 distinguishes itself from fiduciary activity in that the funds are Government owned. It is our position that the funds on deposit in the FMS Trust Fund are owned by the foreign government and not US Government owned.

We request the FASAB to consider the following information. The FMS program is a non-appropriated program through which eligible foreign governments purchase defense articles, services, and training from the United States government. The purchasing government pays all cost that may be associated with a sale. In essence, there is a government-to-government agreement, normally documented on a Letter of Offer and Acceptance between the US government and a foreign government. Under FMS, military articles and services, including training, may be provided from DOD stocks or from new procurement. If the DOD requires new procurement, the US government agency or military department assigned cognizance for this case is authorized to enter into a subsequent contractual arrangement with US industry in order to provide the article or service requested. Foreign governments place funds into the FMS Trust Fund based on a forecast of future financial requirements to ensure funds are available when needed. These funds belong to the foreign country and are to be returned if the program is modified or cancelled.

DOD asserts the FMS Trust Fund has a fiduciary responsibility to foreign customers until a US government agency or military department fulfills the contractual requirements with the foreign customers. The foreign country or foreign entity has the right to use and invest their funds as they see fit until funds are expended from the FMS Trust Fund to meet payments to either the US Government or the independent contractor. This position is supported by a Comptroller General Decision dated October 15, 1980 (B-200227 O.M.).

Until a military department has provided an item from stock, the foreign government/ entity can exercise control over funds residing in the FMS Trust Fund. At the time a stock item is removed from the military department's inventory, shipped to the foreign entity and billed, the FMS Trust Fund will reimburse the military department for its cost. The military department will record and recognize earned revenue. The FMS Trust Fund maintains the fiduciary funds as a non-federal entity until the federal entity (a military department) performs in accordance with the contract. While the FMS Trust Fund contains funds received in advance of the Federal component providing goods or services, we believe the account is fiduciary. Accordingly, the unearned revenue exemption should not apply to activity in the FMS Trust Fund. We recommend paragraph 13 of the revised Exposure Draft be modified to exclude activities where the fiduciary funds owner maintains control over the funds.

The second concern of the DOD centers on non-repayable credit funds appropriated specifically to fulfill international agreements. The United States has entered into agreements, such as the Camp David Accord and made a commitment of funds to a foreign country. Most of these funds are deposited in an interest bearing account in the Federal Reserve Bank in the name of the foreign country in accordance with the Arms Export Control Act. Some of these funds in the Federal Reserve Bank account are spent outside the Foreign Military Sales arena in accordance with the Arms Export Control Act. The remaining funds are merged into the FMS Trust Fund (again in accordance with the Arms Export Control Act) when required to meet financial requirements of the FMS contracts for goods or services. The country has an ownership interest because it can spend and move the funds as it sees fit within the requirements of the Arms Export Control Act. There is a "binding agreement" in place and it is supported by statute. It is our position that even though the non-repayable credit funds originated as appropriated funds, once they were expended from the originating appropriation to the Federal Reserve Bank Interest bearing account or FMS Trust Fund, the funds meet the definition of fiduciary activity.

In summary, DOD believes FMS funds, whether originating as foreign customer deposits or as appropriated for the purpose of facilitating FMS sales meet the definition of fiduciary; and that neither the paragraph 13 exclusion nor Standard 27 applies. DOD would like the FASAB to clarify the revised Exposure Draft to clearly articulate this position.

STATEMENT OF

DEBRA J. CAREY,
U.S. DEPARTMENT OF THE INTERIOR

BEFORE THE
FEDERAL ACCOUNTING STANDARDS ADVISORY BOARD

REGARDING THE EXPOSURE DRAFT ENTITLED
"ACCOUNTING FOR FIDUCIARY ACTIVITIES"

August 17, 2005

It is a pleasure to be here before the FASAB Board to discuss with you the Exposure Draft entitled "Accounting for Fiduciary Activities." I have with me Margaret Williams, Deputy Special Trustee for Trust Services in the Office of the Special Trustee for American Indians; Bert Edwards, Executive Director of the Office of Historical Trust Accounting; and Fred W. Winter, a partner with the accounting firm KPMG. We appreciate the hard work that has gone into drafting this document and the consideration the Board has given to our previous comments.

We have four main comments on the Exposure Draft :

1. Additional guidance or clarification is needed regarding the application of paragraph 14, Basis of Accounting, to the Indian Trust Fund environment.
2. The scope of the fiduciary definition may remove items from the balance sheet that should remain on this statement. In addition, Fund Balance with Treasury and other asset accounts should not be split between fiduciary and non-fiduciary.
3. Paragraphs 142 and 276 of Statement of Federal Financial Accounting Standards (SFFAS) No. 7, related to Minerals Management Service oil and gas collections, should be left in tact or rescinded rather than edited.
4. The sample footnote disclosures and pro forma transactions provided in the Appendices of the Exposure Draft are too specific, and may create confusion. We believe that the pro formal transactions and the bulk of the sample disclosures should be deleted. We will provide specific comments in this area in the form of a comment letter.

I intend to keep our comments brief in order to provide as much time as possible for questions from the Board.

<u>Basis of Accounting</u>

As it applies to Indian Trust assets, we believe that on the whole, this standard is appropriate. However, paragraph 14 states:

> "Fiduciary activities reported in the Federal entity's notes to the financial statements, as required in paragraphs 15-21, should be disclosed in the required schedules and

measured using the standards provided in generally accepted accounting principles applicable to the Federal Government."

On the surface, this requirement is benign. However, the nature of certain uncollected revenues due to beneficiaries makes a strict application of this provision problematic. Currently, accruals are made for certain interest receivable amounts and similar revenues where the amount due can be determined with accuracy and collection is nearly certain. However, for many receivables, such as land-use rents based on agricultural production or number of grazing livestock, the amount is not reasonably estimable. Thus, collection of the estimated amount is likewise not certain. We believe that accrual of these receivables would be misleading to the reader. Accrual accounting principles strictly limit the recognition of items which cannot be reasonably estimated, especially on the asset side of the balance sheet. It would be helpful to the Indian Trust situation if language could be added limiting the accruals for speculative amounts.

Fiduciary Defintion

In our previous comments, we stated that we concurred with the definition of Fiduciary Assets. Our position on the scope of Fiduciary Assets is unchanged. Specifically, we believe that the reporting requirements in this document for Fiduciary Assets should be applied to an extremely narrow group of assets. In these limited situations, the assets should not be presented on the balance sheet of any Federal agency.

However, since the release of the original Exposure Draft, we have noted that the Fiduciary Asset definition has been interpreted more broadly than we feel is correct. In fact, the stated exclusions of payroll withholdings and advances related to the sale of goods and services indicates that the definition is sweeping in activities well beyond our initial interpretation of the fiduciary definition. In general, we believe that Fiduciary Asset treatment is appropriate for the Thrift Savings Plan and Indian Trust Funds. These activities share certain characteristics, including:

1) An absolute certainty of non-federal ownership,
2) A contractual arrangement governing the relationship between the Federal Government and the Trust beneficiaries. This contract may be in the form of legislation and/or regulation.
3) The contractual arrangement, explicitly or implicitly, requires that specific accountability and reporting standards be met, including but not limited to:
   a) Maintenance of a self balancing set of accounts for the fund.
   b) Issuance of regular, periodic statements to account owners indicating opening balance, additions, withdrawals, and closing balance.
   c) Independent audit of the self-balancing set of accounts.

We believe that all assets, regardless of label, not meeting this high level of fiduciary control should remain on the balance sheet of the agency as an asset and offsetting liability.

From a practical standpoint, this accounting treatment could be accomplished in one of two ways. First , the factors above could be incorporated into the definition . Second, the definition could be left unchanged but the default reporting treatment be revised. Specifically, the reporting treatment could call for footnote disclosure in lieu of balance sheet recognition only when the factors above are met.

Further, we do not believe that any special asset accounts are needed to track or manage the funds remaining on the balance sheet. We do not concur with splitting Fund Balance with Treasury (FBWT) between fiduciary and non-fiduciary, especially given the implications of the current definition. In many of these situations, collections cannot be differentiated between Federal and non-Federal. The collections are properly commingled. It is the purpose of a liability to make this distinction. In addition, the proposed split to FBWT for budgetary versus non-budgetary activity is outside the scope of this standard and should be addressed elsewhere when more consideration can be given the implications of the proposal.

One other type of fiduciary arrangement may exist. Specifically, a true escrow arrangement may warrant fiduciary treatment. In a true escrow arrangement, the Federal government is acting as an independent third party, and is holding funds to ensure performance on a contract that the Federal government is not itself a party to. This may be the situation at the Department of Defense. We take no position on the treatment of true escrow accounts. However, Interior has a number of accounts labeled "escrow" where the money may revert to the Federal government under certain conditions. Thus, the funds have not been entrusted to an "independent third party." We do not believe that these are escrow accounts in the private sector use of the concept. Interior believes that balance sheet recognition of these "escrow" accounts should continue.

Minerals Management Service Collections

Paragraphs 142 and 276 of SFFAS #7 should be left in tact or rescinded rather than edited. Interior concurs with the intent of the requirements related to oil and gas royalty collections as prescribed by SFFAS #7. However, the application of these requirements has created a great deal of confusion, especially in the preparation of government-wide financial statements.

In addition, with rare exceptions, these collections are not fiduciary in nature. We believe a full look at the reporting requirements related to these revenues should be included in the Natural Resources project or as a stand-alone project where more attention can be paid to the implications of the requirements and proposed changes. Inclusion of these edits as part of the Accounting for Fiduciary Activities standard is inappropriate.

As stated earlier, we will forward our more technical comments regarding the sample disclosures and pro forma transactions to the Board during the comment period.

Thank you for the opportunity to address the Board on this important issue. We look forward to answering any questions you may have.

Responses Received: Staff Analysis and Recommendations

The following staff analysis is in two parts:

- Part One reviews the written responses to the eleven specific questions for respondents that were published in the Exposure Draft (ED).

- Part Two reviews the written responses and the oral testimony at the August 17, 2005 public hearing that relate to additional issues in the ED.

Written responses received:

1.	Association of Government Accountants	Russell Hinton, Chair, AGA Financial Management Standards Board
2.	Dept. of Commerce	James Taylor, DCFO
3.	DoD DCFO	Terri McKay, DCFO
4.	DoD OIG	Marvin Peek, Director, DoD Financial Statement Audit
5.	Greater Washington Society of CPAs	Dan Kovlak, Chair, GWSCPA Federal Issues and Standards Committee
6.	Dept. of Housing and Urban Development	Frank Murphy, Director, Financial Policy & Procedures
7.	Dept. of the Interior	Ross Swimmer, Office of the Special Trustee for American Indians
8.	Dept. of the Interior	Dan Fletcher, Associate Director, Financial Statements and Systems
9.	Dept. of Justice	Melinda Morgan, Director, Justice Mgmt. Finance
10.	Dept. of Justice OIG	Mark Hayes, Assistant Director, OIG
11.	Library of Congress OIG	Nicholas Christopher, Assistant IG
12.	Dept. of the Treasury DCFO	James Lingebach, Acting DCFO
13.	Dept. of the Treasury GWA	Jim Sturgill, Assistant Commissioner for Government-wide Accounting
14.	Hal Steinberg	Former FASAB Board Member

Oral statements presented by:

15.	DoD DFAS	Zack Gaddy, Director, Defense Finance and Accounting Service
16.	Dept. of the Interior	Debra Carey, Focus Leader for Data Stewardship, Office of Financial Management

Part One: Summary of Responses by Question:

1. Do you agree that the definition in paragraph 10 covers all potential fiduciary activity in which Federal entities engage? If not, please provide specific examples.

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO		X	
DoD OIG	X		
GWSCPA		X	
HUD	X		
Interior- Swimmer			X
Interior- Fletcher		X	
DOJ	X		
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg	X		

Summary of responses:

Eleven of the fourteen respondents agreed with, or had no objections to, the definition.

<u>Foreign Military Sales</u>
The Department of Defense (DoD) Deputy Chief Financial Officer (DCFO) recommended that the definition be amended so that all Foreign Military Sales (FMS) funding, including transfers from appropriations and funds not necessarily subject to "judicial remedies" be included in fiduciary activities. The DoD DCFO also recommends that the definition be amended to clearly include other funds that are deposited in the Federal Reserve Bank under the name of the foreign country. It is the DCFO's position that those funds meet the definition of fiduciary activities, although it is uncertain whether judicial remedies are available to the foreign country. However, the DoD OIG agrees with the definition and considers the FMS Trust Fund to be primarily unearned revenue, and hence not subject to the fiduciary activities reporting requirements.

<u>Scope of Definition</u>
The Greater Washington Society of CPAs (GWSCPA) Federal Issues and Standards Committee and the Department of the Interior (Fletcher) also disagreed with the definition, stating that it might "open the way for clearly non-fiduciary activities to be accounted for outside the entity" such as deposits or bonds from prospective buyers of government property. In addition, it recommended that the definition should be expanded to clearly include oil and gas royalties collected by the Department of the Interior and distributed to states.

Attachment 2: Staff Analysis and Recommendations

Staff analysis:
Both the DoD DCFO and the DoD OIG agree that the funds in the FMS Trust Fund, including funds that were transferred from appropriations, primarily represent unearned revenue. The ED exempts unearned revenues from the reporting requirements for fiduciary activities because unearned revenue should be recognized as a liability on the balance sheet. As noted in paragraph 46 in the Basis for Conclusions, such liabilities should be recognized on the balance sheet, and not omitted from the balance sheet and disclosed as “fiduciary activities.”

As for appropriated funds (“non-repayable credit funds”) that are deposited in the name of the foreign country in the Federal Reserve Bank and spent “outside the FMS arena,” staff agrees with the DoD DCFO that those funds appear to meet the definition of a fiduciary activity. However, it is the responsibility of the DoD, together with its OIG, to examine the provisions of the agreements and to determine whether there is a fiduciary relationship in accordance with the proposed definition of fiduciary activity, subject to the proposed fiduciary reporting requirements.

Staff does not agree with the GSWCPA or the Department of the Interior (Fletcher) that the definition might “sweep in” such items as bonds or deposits from prospective buyers of government property, because those items would be subject to the “unearned revenue” exclusion. In terms of the recommended expansion of the definition, such as to include oil and gas royalties related to state-owned land, such royalties would appear to already meet the definition of fiduciary activity in the ED; hence no revision should be necessary.

Staff recommendation:
Staff does not recommend any changes in the proposed definition.

Question for the Board:
Does the Board agree with staff recommendation?

2. Do you agree that the description of payroll withholdings and garnishments is adequate? If not, please provide specific examples of activities that might or might not be classified as "payroll withholdings" or "garnishments."

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO	X		
DoD OIG	X		
GWSCPA	X		
HUD	X		
Interior- Swimmer			X
Interior- Fletcher			X
DOJ	X		
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg			X

Summary of responses:

None of the respondents disagreed with the description of payroll withholdings and garnishments.

The GWSCPA recommended that the Board clarify the reason why the ED proposed excluding them from the reporting requirements for fiduciary activities. The Department of the Interior (Fletcher) said that all short-term pass-through activity, not only payroll withholdings and garnishments, should be excluded.

Staff analysis:

Staff does not recommend any changes to the description of payroll withholdings and garnishments.

The explanation for the exclusion of payroll withholdings and garnishment is in paragraph 46 of the Basis for Conclusions of the ED, which states that:

> The standard excludes payroll withholdings and garnishments. Payroll is an element of the Government's cost of operations. A Federal component entity may utilize a deposit fund to temporarily hold amounts payable to state or local governments or other entities for taxes withheld or amounts garnished. Although deposit funds are "non-entity" funds (not government-owned), the substance of the transaction is that the amounts are still payable to the ultimate payee. Amounts payable for goods or services received by a Federal component entity should be recognized on the balance sheet, and should not be omitted from the balance sheet and disclosed as "fiduciary activity."

Staff believes that the above explanation is adequate and that it should be retained in the final Basis for Conclusions section.

Staff recommendation:
Staff recommends no changes.

Question for the Board:
Does the Board agree with staff recommendation?

3. Do you agree that payroll withholdings and garnishments should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13, and Basis for Conclusions, paragraph 46.) If not, please explain why you disagree.

	Agree	Disagree	Not Addressed
AGA	**X**		
Dept. of Commerce	**X**		
DoD DCFO	**X**		
DoD OIG	**X**		
GWSCPA	**X**		
HUD	**X**		
Interior- Swimmer			**X**
Interior- Fletcher	**X**		
DOJ	**X**		
DOJ OIG	**X**		
LOC			**X**
Treasury DCFO	**X**		
Treasury GWA			**X**
Hal Steinberg	**X**		

Summary of Comments:

None of the respondents disagreed with the exclusion of payroll withholdings and garnishments from the proposed fiduciary reporting requirements.

In its response to questions #3 and #4, the Dept. of Justice recommended that there should be an additional exclusion for seized monetary assets. This recommendation is addressed in the response to Part Two of this paper, Major Issue #2, page 103.

Staff recommendation:
Staff recommends no changes to the exclusion of payroll withholdings and garnishments.

Question for the Board:
Does the Board agree with staff recommendation?

4. Do you agree that unearned revenue should be excluded from the fiduciary reporting requirements? (See "Exclusions," paragraph 13 and Basis for Conclusions, paragraph 46.)

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO		X	
DoD OIG	X		
GWSCPA	X		
HUD	X		
Interior- Swimmer			X
Interior- Fletcher	X		
DOJ	X		
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg	X		

Summary of comments:

Most of the respondents (thirteen out of fourteen) agreed with, or had no objections to, the exclusion of unearned revenue from the proposed fiduciary reporting requirements.

Foreign Military Sales
The DoD DCFO indicated that advance payments received from foreign governments to purchase goods and services under the Arms Export Control Act and placed into the FMS Trust Fund do not qualify as unearned revenue. However, the DoD OIG believes that the advance payments do qualify as unearned revenue and are properly excluded from the reporting requirements for fiduciary activities.

Seized monetary instruments
In its response to questions 3 and 4, the Department of Justice (DOJ) recommended that seized monetary instruments continue to be recognized on the Balance Sheet. This issue is addressed in Part Two of this paper, Major Issue #2, page 103.

Definitions
The Treasury Department recommends that, "there needs to be a more comprehensive definition of the terms "unearned revenue," "prepayments" and "advances" in paragraph 13 and the definition of "unearned revenue" in the Appendix B Glossary," and stated agreement with the DoD testimony on August 17, 2005, that the clarification should exclude FMS advance payments from unearned revenue.

Attachment 2: Staff Analysis and Recommendations

Staff analysis:
Staff agrees with the DoD OIG that advance payments in the FMS Trust Funds do meet the definition of unearned revenue and that the definition and/or exclusions should not be modified in such as way as to exclude them.

Staff does not agree with Treasury's request for "a more comprehensive definition of the terms "unearned revenue," "prepayments" and "advances" in paragraph 13." Staff believes that the proposed fiduciary standard is not the appropriate venue for amending the definitions of elements such as revenue and revenue-related assets and liabilities. "Unearned revenue" is defined in SFFAS 1, paragraphs 41 and 85, and SFFAS 7, paragraph 37. The glossary definition for "unearned revenue" in the ED cites those paragraphs and is taken directly from them.

Staff recommendation:
Staff recommends adding the definitions of "advances" and "prepayments" to the Appendix B Glossary. The definitions of those terms are in SFFAS 1, *Accounting for Selected Assets and Liabilities,* paragraphs 57 and 58.

Question for the Board:
Does the Board agree with staff recommendation?

5. Do you agree with the financial reporting treatment of fiduciary assets and liabilities, and the inflows and outflows of fiduciary activities? See paragraphs 14 and 15-21 for the standard regarding Federal component entities; and see paragraphs 14 and 22-27 for the standard regarding the Financial Report of the United States Government. See paragraphs 36-58 in the Basis for Conclusions for the rationale.

	Agree	Disagree	Not Addressed
AGA		X	
Dept. of Commerce	X		
DoD DCFO	X		
DoD OIG	X		
GWSCPA		X	
HUD		X	
Interior- Swimmer		X	
Interior- Fletcher		X	
DOJ		X	
DOJ OIG	X		
LOC		X	
Treasury DCFO		X	
Treasury GWA		X	
Hal Steinberg		X	

Summary of comments:

Most of the respondents (ten out of fourteen) disagreed with some aspect of the financial reporting treatment of fiduciary assets, liabilities, inflows and outflows.

Retain Balance Sheet Reporting for Some/All Fiduciary Assets and Liabilities
Six respondents (DOJ, HUD, Interior (Fletcher), LOC, Treasury Acting DCFO and Steinberg) plus one of the members of the GWSCPA disagreed with the proposal to remove some or all fiduciary assets and liabilities from the Balance Sheet. Treasury GWA objected to "notes only" disclosure.

Copyright Licensing Royalty Receipts and Disbursements
The Library of Congress noted that this presents unintended consequences in cases where activities that are clearly fiduciary are also included in the budget. As an example, Copyright Licensing Royalty Receipts and Disbursements are currently in the Budget. Although the LOC intends to consult with the Office of Management and Budget about removing this activity from the budget, this situation is always possible. As noted in previous briefing materials[1], the Indian tribal funds were included in the Federal budget prior to FY 2000. When fiduciary activities are included in the Budget and reported on the Statement of Budgetary Resources (SBR), that

[1] See Fiduciary Activities Briefing Book, Tab 9. (The Fiduciary Activities Briefing Book was distributed to Board members with the Briefing Materials for the October 2004 Board Meeting.)

statement will not articulate to the Balance Sheet if fiduciary assets are removed from the Balance Sheet and disclosed in the notes.

Staff analysis:
One of the reasons that the Board originally rejected the proposal to present fiduciary activities as a principal financial statement was that such as statement would not articulate with the Balance Sheet. If fiduciary activities that are in the Budget are excluded from the Balance Sheet, the SBR will not articulate with the Balance Sheet.

If fiduciary assets were to be retained on the balance sheet, a separate fiduciary principal financial statement would articulate with the balance sheet. However, as noted in paragraph 47 of the Basis for Conclusions, "The Board considered whether recognizing fiduciary assets on the balance sheet might imply not only managerial control over the assets, but also that the benefits of the assets accrue to the Federal component entity. The Board decided that fiduciary assets should not be recognized on the Balance Sheet of the Federal component entity because they are not assets of either the Federal component entity or the Federal Government as a whole."

Staff recommendation:
Staff requests that the Board consider whether being included in the Federal Budget precludes meeting the definition of "fiduciary," since inclusion in the Budget implies government ownership.

If the Board determines that inclusion in the Budget does not preclude non-Federal ownership, staff recommends that fiduciary activities that are included in the Budget of the United States should be excluded from the fiduciary reporting requirements. Accordingly, the related assets would be recognized on the Balance Sheet of the reporting entity. This would maintain consistency between the SBR and the Balance Sheet.

Question for the Board:
Does the Board agree with staff recommendation?

Seized assets should continue to be reported on the Balance Sheet
The Department of Justice, the Department of the Treasury Acting DCFO, and Hal Steinberg recommended that seized assets should continue to be reported on the Balance Sheet.

This issue is addressed in Part Two of this paper on page 103, Major Issue #2.

All fiduciary assets should continue to be reported on the Balance Sheet.
The Department of the Treasury Acting DCFO, the Library of Congress, the Department of Housing and Urban Development and the Department of Justice disagreed with the proposal to remove fiduciary assets and liabilities from the Balance Sheet.

The Department of Justice said that this "would reverse improvements that have brought federal financial reporting closer to the levels of relevance and accountability targeted for general purpose financial statements in the private sector." The Department of the Treasury and the Library of Congress noted that it would be more difficult to automate the compilation and consolidation of the financial statements if fiduciary assets and liabilities were reported in a note rather than on the face of the Balance Sheet.

Basis of Accounting
The Department of the Interior (Fletcher) said that the accrual basis of accounting should not be required for fiduciary activities. This issue is addressed in Part Two of this paper, Major Issue #4.

Staff analysis:
Staff agrees with the Treasury Acting DCFO and the Library of Congress that it might be more difficult to automate the compilation and consolidation of the financial statements to report fiduciary assets and liabilities in a note rather than on the face of the Balance Sheet. The response from the Treasury Assistant Commissioner for Government-wide Accounting notes that difficulties are encountered in the preparation of the FR when dealing with "notes only" disclosures.

Staff recommendation:
Staff recommends that the Board reconsider either recognizing fiduciary activities in a separate principal financial statement or amending the Statement of Custodial Activity and retaining fiduciary assets on the Balance Sheet. That proposal is considered in Part Two of this paper.

Questions for the Board:
Questions for the Board for resolving this issue appear in Part Two of this paper, starting on page 103.

6. Do you agree with the requirement in paragraph 17 that, with respect to certain financial information required in paragraph 16, there should be separate reporting for individual fiduciary activities and total fiduciary activities? If you do not agree, what display would you recommend?

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO	X		
DoD OIG	X		
GWSCPA	X		
HUD	X		
Interior- Swimmer			X
Interior- Fletcher		X	
DOJ		X	
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg			X

Summary of Comments:

Most respondents (twelve out of fourteen) agreed with, or did not object to, this requirement.

This question was somewhat unclear because paragraph 18 described separate reporting for individual fiduciary activities (within a single Federal component entity), but paragraph 17 referred to fiduciary activities that were managed by more than one Federal component entity.

Disclosure of Other Managing Components
The GWSCPA recommended that when more than one Federal component entity is responsible for a fiduciary activity, each reporting Federal component should disclose the other entities that are partially responsible.

Disclosure for a "Central Fund"
The DOJ interpreted paragraph 17 to mean that when seized property financial records are maintained and reported by a "central fund" created to support the seizure activities of one or more Federal components, that it would not be cost effective to apply this requirement. (The DOJ OIG addressed paragraph 18, but not paragraph 17.)

Staff analysis:
Staff agrees with the GWSCPA recommendation that each reporting component should disclose the other reporting components involved in managing the activity.

Staff believes that the intent of this provision was not to split up a central fund managed by one component entity. Staff agrees that the requirements for paragraph 17 should not be applied to a central fund such as the one described by the DOJ.

Staff recommendations:

1.) Staff recommends the following revision to the second sentence of paragraph 17:

If more than one Federal component entity is responsible for administering a fiduciary activity, and the separate portions of the activity can be clearly identified with a responsible component entity, then each component entity should disclose its portion in accordance with the requirements of this standard**, and should also identify the other Federal component entities that administer separate portions of the activity.**

2.) Staff recommends the following revision to the last sentence of paragraph 17:

If separate portions cannot be identified, **or if the fiduciary transactions are maintained and reported in a "central fund,"** the component entity with program management responsibility should disclose the fiduciary activity.

Question for the Board:

Does the Board agree with staff recommendations?

7. Do you agree that component entities with immaterial amounts of fiduciary net assets should be aggregated in the list of component entities in the fiduciary note disclosure of the Financial Report of the U.S. Government?

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO	X		
DoD OIG	X		
GWSCPA	X		
HUD	X		
Interior- Swimmer			X
Interior- Fletcher		X	
DOJ		X	
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg			X

Summary of Comments:

Most of the respondents (twelve out of fourteen) agreed with or did not object to the provision that component entities with immaterial amounts of fiduciary net assets should be aggregated in the Financial Report of the U.S. Government (FR). However, the Department of Commerce, the Department of Justice, the Library of Congress, the Department of the Treasury Acting DCFO, and several members of the GWSCPA disagreed with the proposal to report fiduciary activities in a note disclosure; that issue is addressed in the response to question #9.

Staff analysis and recommendation:

Staff did not see any compelling argument against aggregating immaterial amounts of fiduciary net assets and does not recommend any changes.

Question for the Board:

Does the Board agree with staff recommendation?

8. This proposed standard rescinds the "dedicated collections" provisions of SFFAS 7 (see paragraph 32 of this Exposure Draft). Do you agree that this proposed standard, together with SFFAS 27, *Identifying and Reporting Earmarked Funds,* addresses all activities formerly classified as "dedicated collections"? If not, please provide specific examples.

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X		
DoD DCFO	X		
DoD OIG	X		
GWSCPA	X		
HUD	X		
Interior- Swimmer			X
Interior- Fletcher	X		
DOJ	X		
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg			X

Summary of Comments:

None of the respondents identified any activities formerly classified as "dedicated collections" that would not be addressed by either SFFAS 27, *Identifying and Reporting Earmarked Funds,* or the proposed standard for fiduciary activities. However, Debra Carey of the Department of the Interior, in oral testimony at the public hearing, noted that Interior has not yet examined all of the Department's "dedicated collections" activities in order to fully respond to this question.

Staff recommendation:

Staff does not recommend any changes.

Question for the Board:

Does the Board agree with staff recommendation?

9. Do you agree that the implementation date (periods beginning after September 30, 2006) is appropriate?

	Agree	Disagree	Not Addressed
AGA			**X**
Dept. of Commerce	**X**		
DoD DCFO	**X**		
DoD OIG	**X**		
GWSCPA	**X**		
HUD		**X**	
Interior- Swimmer			**X**
Interior- Fletcher	**X**		
DOJ		**X**	
DOJ OIG	**X**		
LOC			**X**
Treasury DCFO		**X**	
Treasury GWA			**X**
Hal Steinberg			**X**

Summary of Comments:

A majority of respondents agreed that the implementation date (periods beginning after September 30, 2006) is appropriate. The AGA noted that this would depend upon when the final standard is issued.

The two respondents likely to be most impacted (DOJ and Treasury Acting DCFO), as well as HUD, noted that the proposed standard would require extensive changes to accounting systems. Treasury's USSGL staff and agency operations representatives have also noted this during FASAB staff outreach visits regarding the ED.

Early implementation

The GWSCPA FISC wrote: "(Paragraph 9) – FISC recommends that those Federal component entities that have been reporting their fiduciary activities essentially in accordance with the provisions of the ultimate standard in the Revised ED be permitted to continue to do so and the early adoption prohibition be altered to permit this. This also impacts Paragraphs 35 and 55."

Staff analysis:

The reason for the prohibition against early implementation is to avoid inconsistencies in government-wide reporting, as explained in paragraph 55 of the Basis for Conclusions. The GWSCPA does not mention, and staff is not aware of, any specific Federal agencies that are currently "essentially in accordance with" the provisions of the ED. However, staff does not object to the GWSCPA proposal.

Staff Recommendations:

a) Staff recommends that paragraphs 9, 35 and 55 be amended to allow Federal component entities that have been reporting their fiduciary activities essentially in accordance with the provisions of the ultimate standard in the Revised ED be permitted to continue to do so.

b) Staff recommends an implementation date no sooner than one full year subsequent to the issuance of the final standard. If issued in January 2006, the implementation date would be FY 2008.

Question for the Board:

Does the Board agree with staff recommendations?

10. One board member disagrees with the proposal to report fiduciary activities in a footnote to an agency's financial statements. That member believes that fiduciary activities should be reported in a standalone financial statement subject to full audit scrutiny. Do you agree with his view that a principal financial statement is needed to enhance visibility and audit scrutiny over fiduciary activities? (See Alternative View, page 23)

Note: For this question, a "disagree" vote means that the respondent agrees with the proposed majority view in the ED. Mixed responses have an "X" in both columns.

	Agree	Disagree	Not Addressed
AGA	X		
Dept. of Commerce	X	X	
DoD DCFO		X	
DoD OIG			X
GWSCPA	X	X	
HUD		X	
Interior- Swimmer		X	
Interior- Fletcher		X	
DOJ	X		
DOJ OIG		X	
LOC			X
Treasury DCFO	X	X	
Treasury GWA	X		
Hal Steinberg			X

Summary of Comments:

A majority (eight out of fourteen) of the respondents disagreed with the alternative view.

The AGA, the Department of Justice, the Department of the Treasury Acting DCFO, the Department of the Treasury Assistant Commissioner for Government-wide Accounting, and one of the members of the GWSCPA FRTIB agreed with the Alternative View, and recommended that the fiduciary activity be presented in a separate financial statement rather than a note disclosure.

The Department of Commerce agreed that a note disclosure is sufficient for Federal component entities but that there should be a separate principal statement for fiduciary activities in the Financial Report of the U.S. Government.

The Department of the Treasury Assistant Commissioner for Government-wide Accounting agreed with the alternative view, and said that Treasury Financial Management Service (FMS) relies on the principal financial statements. "When certain collection activity is permitted to be excluded from the component entities' principal financial statements, this leads to increased difficulty for FMS to correctly obtain and record this collection activity, whether it is a custodial or fiduciary activity."

The GWSCPA agreed with footnote disclosure, but stated that for material fiduciary activities that produce stand-alone audited financial statements, the note disclosure should also include how a reader can access the separate financial statements.

Amend the Statement of Custodial Activity
The GWSCPA said that one member of the GWSCPA agrees with the Alternative View, but that fiduciary activities should be included in the Statement of Custodial Activity rather than a separate statement. The Department of the Treasury also said that there was insufficient justification to precluding amending the Statement of Custodial Activity to include fiduciary activities. This issue is addressed in Major Issue 3, "Amend the Statement of Custodial Activity," in Part Two of this paper

Staff recommendation:
Staff recommends that the Board separately consider two of the recommendations in Part Two of this paper, regarding

(a) The Statement of Custodial Activity (Major Issue #3) and
(b) Fiduciary activities with separate audited financial statements (Major Issue #1).

Questions for the Board:
Questions for the Board on this issue appear in Part Two of this paper, in the discussion of Major Issues #1 and #3.

11. One board member disagrees with the proposed reporting requirements for the Financial Report of the U.S. Government (FR). That member believes that differences in reporting between the FR and component Federal entities should be limited to unique or unusual reporting issues. Do you agree with his view that fiduciary activity reporting requirements for the FR should be consistent with requirements for the component entities? (See Alternative View, page 26.)

Note: (For this question, an "agree" designation means that the respondent agrees with the alternative view, and not with the proposed reporting requirements in the ED.)

	Agree	Disagree	Not Addressed
AGA		X	
Dept. of Commerce	X		
DoD DCFO		X	
DoD OIG			X
GWSCPA		X	
HUD	X		
Interior- Swimmer			X
Interior- Fletcher	X		
DOJ	X		
DOJ OIG	X		
LOC			X
Treasury DCFO	X		
Treasury GWA			X
Hal Steinberg			X

Summary of Comments:

Six respondents agreed with the Alterative View; three disagreed, and five did not address it.

Staff Analysis and Recommendation:
Staff does not believe that the ED offered any compelling argument as to why the requirements for the FR should be drastically dissimilar from the reporting on the component entity level.

Staff recommends that the reporting requirements for the FR be parallel to the reporting requirements of the Federal component entities.

Question for the Board:
Does the Board agree with staff recommendation?

Part Two: Written responses and oral testimony at the public hearing that relate to issues in the ED other than specific issues that were identified in the eleven questions.

The following major issues were raised:

1. Reporting on Fiduciary Activities with Separately Audited Financial Statements
2. Seized monetary instruments should continue to be reported in accordance with SFFAC 3.
3. Amend the Statement of Custodial Activities to include fiduciary activity.
4. The Department of the Interior asserts that cash or modified cash basis should be acceptable for fiduciary activity reporting.
5. The Thrift Savings Fund is currently not included in the Government-wide FR.

The following technical issues were raised:

1. Amend or eliminate illustrations of General Fund accounting and other illustrative material.
2. Improve the clarity of proposed amendment to SFFAC 2.
3. Add definitions of advances, prepayments and other terms to the glossary in Appendix B.

Attachment 2: Staff Analysis and Recommendations

Major Issue 1: Reporting on Fiduciary Activities with Separately Audited Financial Statements

In its written response and oral testimony at the public hearing, the Department of the Interior agreed that the note disclosure should contain information relating to the fiduciary relationship, the nature of the Federal government's fiduciary responsibilities and how they are managed, as well as any contingent liabilities relating from the activity, but that "we do not believe the disclosure should require the re-casting of a set of financial statements, which are already audited on a stand-alone basis, in the footnotes of another set of financial statements."

Staff analysis:

Staff believes that Interior's argument may have some merit. In addition to the Indian Trust Funds, the Thrift Savings Fund also has stand-alone audited financial statements. The Thrift Savings Fund financial statements are on a full accrual basis and have consistently received an unqualified audit opinion; however, the financial statements are issued on a calendar year basis. The staff recommendation below would actually improve the FR disclosure regarding the Thrift Savings Fund, which currently is not disclosed at all in the FR.

Note: although the Federal Retirement Thrift Investment Board (FRTIB) has not provided written comments, a representative has informally explained to FASAB staff that the FRTIB is only authorized to incur expenses that promote the interests of its beneficiaries, and that, for example, additional audit procedures to comply with the proposed standard due to the difference in year-end, would not promote the interests of the beneficiaries.

Staff believes that it may not be cost-effective to re-cast information so that it can appear in two different sets of audited financial statements. There are differences in fiscal year-end (for example, the Thrift Savings Fund financial statements have a December 31 fiscal year-end) and, in the case of Interior, differences in basis of accounting.

Also, the GWSCPA notes that, "as in the state and local government environment, disclosure should include how a reader of an entity's PAR and the Financial Report of the USG can obtain such financial reports." Staff agrees with this recommendation.

Staff recommendations:

Staff recommends that in addition to the required narrative regarding the fiduciary activity, the fiduciary note should (1) disclose the current or the most recent audit opinion and (2) provide detailed information on how the reader can access the stand-alone audited financial statements.

Staff also recommends that the Board consider whether the requirement for the re-casting of data that appears in separate audited financial statements should be condensed or eliminated. Currently, this would apply primarily to the Thrift Savings Fund and the Indian Trust Funds.

Question for the Board:
Does the Board agree with staff recommendation?

Major Issue 2: Seized Monetary Assets

The Department of Justice (DOJ) believes that seized monetary instruments should continue to be recognized on the Balance Sheet. The Department of Justice (DOJ) notes that seized monetary instruments share many similarities with unearned revenue and recommends an additional exclusion for seized monetary assets, proceeds from pre-forfeiture sales of seized property, cost bonds and income from property under seizure. Although ownership becomes a tenuous legal concept upon the inception of a seizure, typically over 90 percent of seized monetary instruments are forfeited and make up more than 60 percent of total forfeiture income. The DOJ notes that: a) the government has an asserted legal interest, b) the government has managerial control over seizure receipts and c) related interest benefits do accrue to the federal component entity. (The Dept. of the Treasury (page 5 of Treasury's written comments) affirms that interest on monetary assets seized for forfeiture accrue to the DOJ, and not to the non-Federal party.) In addition, the DOJ believes that recognition of seized monetary instruments with a related offsetting liability will best achieve reporting objectives 2 and 3 in SFFAC 1.[2]

Former FASAB Board member Hal Steinberg also disagreed with changing the reporting standards for seized monetary instruments. He said that, "The fiduciary responsibility for seized monetary assets has not changed, so why should the accounting standard change. The rationale for reporting the asset and liability on the Balance Sheet was to establish control for a highly sensitive, easily valued asset. The need is no less today than it was when SFFAS 3 was issued."

Staff analysis:
Staff agrees with the DOJ that the substance of "seizure for forfeiture" may not meet the intended definition of fiduciary activity. Staff agrees with the DOJ and former Board member Steinberg that the proposed standard should not change the reporting requirements for seized monetary instruments, which are currently specifically addressed in SFFAS 3, paragraphs 61 and 69. SFFAS 3 requires seized monetary instruments to be recognized on the balance sheet with an offsetting liability. SFFAS 3 states that, "Seized monetary instruments are recognized upon seizure due to (1) the fungible nature of monetary instruments, and (2) the high level of control over the assets that is necessary."[3]

Staff recommendation:
Staff recommends that seized monetary instruments, including seized cash, invested seizure receipts, cost bonds and income from property under seizure, should be excluded from the fiduciary reporting requirements and continue to be recognized on the balance sheet with an offsetting liability, in accordance with the provisions of SFFAS 3, paragraphs 61 and 69. Staff believes that the proceeds from pre-forfeiture sales may already be excluded by the "unearned

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[2] Objective 2: Federal financial reporting should assist report users in evaluating the service efforts, costs and accomplishments of the reporting entity; the manner in which these efforts and accomplishments have been financed; and the management of the entity's assets and liabilities.
Objective 3: Federal financial reporting should assist report users in assessing the impact on the country of the government's operations and investments for the period and how, as a result, the government's and the nation's financial condition has changed and may change in the future. (SFFAC 1)

[3] SFFAC 3, paragraph 61.

revenue" exclusion, and also that seized monetary instruments share many characteristics of unearned revenue and should be excluded from the fiduciary reporting requirements.

Questions for the Board:

1. Does the Board agree with staff recommendation?

2. Would the Board prefer to defer a decision on this issue, and request a research paper prepared by staff and/or an information session with DOJ management regarding seized monetary assets?

Major Issue 3: Amend the Statement of Custodial Activity to include fiduciary activity.

The GWSCPA said that one member of the GWSCPA agrees with the Alternative View, but that fiduciary activities should be included in the Statement of Custodial Activity rather than a separate statement. The Department of the Treasury also said that the ED provided insufficient justification to preclude modification of the Statement of Custodial Activity to include fiduciary activities.

Staff analysis:
Staff believes that there are good arguments both for and against amending the Statement of Custodial Activity to include fiduciary activities. Below are some examples.

Pro:
- There are similarities between custodial and fiduciary activity. In both cases, the component entity is collecting and disbursing assets whose benefits do not accrue to the component entity.
- The Statement of Custodial Activity is understandable to readers.
- Federal preparers and auditors are already familiar with the preparation and audit of the Statement of Custodial Activity.
- This proposal would eliminate the need to make the component-level financial statements more cumbersome by adding either a lengthy footnote or an additional principal financial statement.

Con:
- There are significant differences between custodial and fiduciary activity. For example, because custodial assets are assets of the Federal government, the Statement of Custodial Activity eliminates to zero on the Government-wide level and accordingly is not displayed in the FR. This would change if the Statement of Custodial Activity is amended to include fiduciary activities.
- The Statement of Custodial Activity articulates to the Balance Sheet, because custodial assets are recognized as non-entity Federal assets on the Balance Sheet. If the Statement of Custodial Activity is amended, it would not fully articulate to the Balance Sheet, unless fiduciary assets were also recognized as non-entity assets on the Balance Sheet.

Question for the Board:
Does the Board have a preference on this issue, or would the Board prefer to defer a decision on this issue, and request a research paper, and/or an information session with Treasury regarding amending the Statement of Custodial Activity?

Major Issue 4: The Department of the Interior asserts that cash or modified cash basis should be acceptable for fiduciary activity reporting.

The Department of the Interior, in particular the response from Ross Swimmer, Special Trustee for American Indians, asserts that the standard should allow for cash or modified cash basis accounting for fiduciary activities.

Staff analysis:
Staff has previously researched this issue, and the Board has previously declined to allow a different basis of accounting for fiduciary activities. Briefing materials from the December 2004 Board meeting are attached for reference in Attachment 3 of this document.

Staff recommendation:
Staff recommends that the Board reaffirm its decision to require accrual accounting for fiduciary activities.

Question:
Does the Board agree with staff recommendation?

Major Issue 5: The Thrift Savings Fund is currently not included in the Government-wide FR.

Although paragraph 2 of the ED mentions the Thrift Savings Fund as an example of fiduciary activity, the Thrift Savings Fund is not currently included in the FR, and although the Federal Retirement Thrift Investment Board (FRTIB) is required to prepare financial statements in accordance with generally accepted accounting principles applicable to the Federal government[4], it does not currently do so.

Although a letter and a copy of the ED were sent to the FRTIB, there has not been a formal response as of this writing. An FRITB staff member has informally explained to FASAB staff that the FRTIB is only authorized to incur expenses that are in the best interests of the beneficiaries of the Thrift Savings Plan, and that additional expenses incurred to report audited data as of September 30th (not the fund's fiscal year-end) would not be in the best interest of the participants.

Staff analysis and recommendations:

Disclose audit opinion and provide information on how to obtain separately audited financial statements

Although the Thrift Savings Fund is the largest fiduciary activity of the Federal government, the above compliance issue is not within the scope of the fiduciary activities ED. Staff recommends that regardless of whether the FRTIB provides September 30th data, the fiduciary note disclosure of the government-wide FR should explain that the assets, liabilities and flows of the Thrift Savings Fund are not consolidated in the FR because they are not government-owned, but that copies of the audited financial statements can be found at the FRTIB website; disclose the audit opinion and provide the website address. For further discussion of this issue, see Major Issue 1, *Reporting on Fiduciary Activities with Separately Audited Financial Statements*.

Allow data from most recent audited financial statements

Staff believes that the Board should also consider allowing the fiduciary note disclosure to include data from the most recent audited financial statements, which could be up to nine months earlier than the financial statement date. This would allow the inclusion of the Thrift Savings Fund data from the previous December 31st, which would result in no additional costs to the Fund.

Question for the Board:

Does the Board agree with staff recommendations?

[4] The FRTIB is subject to the Accountability of Tax Dollars Act of 2002 (PL 107-289), and is specifically named in the December 6, 2002 OMB "Memorandum for Heads of Selected Executive Agencies" as being subject to the provisions of OMB Bulletin 01-019, "Form and Content of Agency Financial Statements" starting in FY 2003.

Attachment 2: Staff Analysis and Recommendations

Technical Issues Raised

Summary
Numerous technical issues were raised by the respondents. Technical issues do not involve the proposed reporting standard, but relate to clarity, grammar, and presentation of the standard. Due to the short time frame between the comment period and this mailing of briefing materials, this paper does not address all technical issues that were raised. However, all technical issues will be considered in the revised draft to be presented to the Board at the January 2006 Board meeting.

This paper presents one technical issue that staff believes requires consideration by the Board, and two other technical issues as examples of the technical issues raised by respondents.

Technical Issue 1: General Fund reporting and other illustrative material (for Board consideration)

Treasury wrote:

"In 1998…it was agreed that the Department of the Treasury reporting entity did not include the General Fund of the Treasury as a component (note Due for the General Fund and Fund Balance with Treasury as assets on the Department's consolidated balance sheet). Accordingly, the Treasury General Fund entity shown in the ED does not currently exist.

We do not believe that this proposed standard can be implemented without resolution of the General Fund of the Treasury entity issue. This ED demonstrates the possible need for a separate standard addressing accounting for the General Fund of the Treasury. While we have been advised by FASAB staff that it does not define reporting entities, we believe that the General Fund of the Treasury is an exceptional situation that affects accounting at all levels of Federal Government reporting."

Also, the Department of the Interior (Fletcher) and the GWSCPA suggested that the illustrative note disclosures and pro forma transactions are too detailed and should be eliminated from the final standard.

Staff analysis:
As Treasury acknowledges, FASAB "does not define reporting entities," nor does FASAB exempt entire entities or sub-entities from reporting requirements. The fiduciary activities ED does not designate either the General Fund or the Bureau of Public Debt as being part of the Treasury reporting entity; it simply illustrates the relationships between and among the Federal component entity with fiduciary activity with the General Fund, the Bureau of Public Debt, and the Government-wide FR.

The relationships and eliminations are complex. Accordingly, the illustration is necessary for preparers and auditors to understand how to coordinate reporting of transactions.

Whether or not the General Fund is a part of the Treasury reporting entity is beyond the scope of the fiduciary activities ED. However, staff believes that regardless of which Federal component the General Fund should be reported in, the General Fund is certainly a component of the Federal government, and staff sees no reason why it should not be displayed in the illustrative transactions.

During the preparation of the ED and during the comment period, staff had extensive contact with Federal preparers, in particular the U.S. Standard General Ledger Board's Issues Resolution Committee and Treasury Government-Wide Accounting, and the preparers agreed that due to the complexity of the accounting involved, particularly concerning eliminations, the illustrative transactions will promote consistent reporting of fiduciary activities, similar to the pro forma transactions that were shown in SFFAS 27, *Identifying and Reporting Earmarked Funds*.

Staff recommendation:
Staff recommends no changes.

Question for the Board:
Does the Board agree with staff recommendation?

Technical Issue 2: Improve the clarity of the proposed amendment to SFFAC 2.

Hal Steinberg wrote:

> I notice paragraph amends paragraph 102 of SFFAC 2. Adding the phrase "should be reported in accordance with the provisions of SFFAS __ *Accounting for Fiduciary Activities*" could be confusing. Some might interpret that phrase to require that deposit funds and withholdings be recorded as fiduciary funds. The existing wording states exactly what is wanted and should be retained. A better reference to SFFAS __ *Accounting for Fiduciary Activities* would be to replace the words "should be reported in accordance with" with the words "as provided for in."

Staff analysis and recommendation:
Staff agrees that this would improve the clarity of the amendment. Staff intends to revise paragraph 33 of the ED per the above recommendation.

Question for the Board:
Does the Board have any objections to staff recommendation?

Technical Issue 3: Add several definitions to the Glossary.

Treasury recommended that the definitions for Unearned Revenue, Advances, and Prepayments be added to the Glossary; the GWSCPA recommended that the definitions for Earmarked Funds and Non-Entity be added to the Glossary.

Staff analysis and recommendation:
The above terms are defined in other FASAB standards, and staff has no objections to adding them to the Glossary.

Question for the Board:
Does the Board have any objection to staff recommendation?

Attachment 3: “Basis of Accounting” from Briefing Materials, December 2004 Board Meeting

Table of Contents:

Basis of Accounting

At the October Board meeting, the Board asked staff to research the issue of whether a modified-accrual or cash basis accounting should be permitted for fiduciary activities. Staff has researched the basis of reporting for fiduciary activities by state and local governments and in the private sector.

A variety of public and private sector organizations engage in fiduciary or fiduciary-like activity. Reporting requirements for these organizations differ and are not always clearly expressed in regulations. In addition, the characteristics of trusts are varied and complex, and do not always conform to the characteristics of “fiduciary activities” that were proposed in the Board’s fiduciary activities ED. Thus, it is difficult to draw parallels between domains and that of federal fiduciary activities and reach conclusions about the appropriate reporting requirements for federal fiduciary activities based on these parallels.

GASB requirements for reporting fiduciary funds

GASB 34

- Defines fiduciary funds
- Requires separate financial statements for fiduciary funds, and
- Requires the accrual basis of accounting for fiduciary funds.

GASB 34 requires that fiduciary funds "be used to report assets held in a trustee or agency capacity for others and therefore cannot be used to support the government's own programs."[5]

GASB 34 describes four categories of fiduciary funds:

1. *Pension (and other employee benefit) trust funds* should be used to report resources that are required to be held in trust for the members and beneficiaries of defined benefit plans, defined contribution plans, other postemployment benefit plans, or other employee benefit plans.
2. *Investment trust funds* should be used to report the external portion of investment pools reported by the sponsoring government, as required by Statement 31, paragraph 18.[6]
3. *Private-purpose trust funds,* such as a fund used to report escheat property,[7] should be used to report all other trust arrangements under which principal and income benefit individuals, private organizations, or other governments.
4. *Agency funds* should be used to report resources held by the reporting government in a purely custodial capacity (assets equal liabilities). Agency funds typically involve only the receipt, temporary investment, and remittance of fiduciary resources to individuals, private organizations, or other governments.[8]

GASB requires that "Financial statements of fiduciary funds should be reported using the *economic resources measurement focus* and the ***accrual basis of accounting***, except for the recognition of certain liabilities of defined benefit pension plans and certain postemployment healthcare plans."[9]

Staff Analysis:
The GASB model aligns with the proposal in Alternative 3. GASB's use of fund types – while meaningful in the state/local environment – is not as relevant to the federal domain. However, it is noteworthy that GASB does not exempt fiduciary activities from accrual accounting.

Private sector requirements: banking industry, not-for-profit organizations, the insurance industry and investment companies

Banks and Savings Institutions

Banks and savings institutions may have custody of and/or manage financial assets that belong to third parties. Laws governing the fiduciary responsibilities of banks and

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[5] GASB 34, par. 69.
[6] The "external portion" is the portion that belongs to legally separate entities that are not part of the primary government and its component units. GASB 31, par. 18
[7] Escheat property is real property for which ownership is unknown.
[8] GASB 34, pars. 70-74.
[9] Ibid., par.107 (bold added).

savings institutions[10] require banking institutions to conduct fiduciary activities through a separate department or division of the institution, a separate trust company, or a contractual arrangement with the trust department or a trust company of another depository institution.[11]

The *AICPA Audit and Accounting Guide: Depository and Lending Institutions* states that trust assets are not assets of the institution and should not be included in the institution's financial statements.[12]

Federal law is silent on the basis of accounting, and simply states that banks and savings institutions "must keep adequate records"[13] for fiduciary accounts.

Staff analysis:
Staff does not believe the treatment described above is relevant. The Board's decision should be based on an assessment of the best means for meeting federal financial reporting objectives since the scope of the proposed standard is the Federal component entity's financial statements, and not special-purpose reports required by a regulatory agency.

Not-for-Profit Organizations

No-for-profit organizations are often trustees of charitable trusts, particularly split-interest trusts, whose assets belong to third parties. The *AICPA Audit Guide: Not-for-Profit Organizations* describes a "split-interest agreement" as follows:

> Under a split-interest agreement, a donor makes an initial gift to a trust or directly to the not-for-profit organization, in which the not-for-profit organization has a beneficial interest but is not the sole beneficiary. The terms of some agreements do not allow donors to revoke their gifts; other agreements may be revocable by donor in certain situations. The time period covered by the agreement is expressed either as a specific number of years (or in perpetuity) or as the remaining life of an individual or individuals designated by the donor. The assets are invested and administered by the organization, a trustee, or a fiscal agent, and distributions are made to a beneficiary or beneficiaries during the term of the agreement. At the end of the agreement's term, the remaining assets covered by the agreement are distributed to or retained by either the not-for profit organization or another beneficiary organization.[14]

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[10] Title 12, Code of Federal Regulations (CFR) Chapter 1, *Office of Comptroller of the Currency*, Part 9 and Chapter 5, *Office of Thrift Supervision,* part 550. State fiduciary laws also may apply.
[11] AICPA *Audit and Accounting Guide: Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies and Mortgage Companies*, par. 17.02.
[12] Ibid., par.19.
[13] 12 CFR 550.410; also see 12 CFR 9.8(a).
[14] *AICPA Audit Guide: Not-for-Profit Organizations*, par. 6.02.

Attachment 3: "Basis of Accounting" from Briefing Materials, December 2004 Board Meeting

Split-interest agreements have such variable characteristics that some individual charitable trusts might closely resemble "fiduciary activities," while others might more closely resemble "earmarked funds."

In addition, there is significant uncertainty as to whether the assets and liabilities of a charitable trust should be included in the financial statements of not-for-profit organizations. The Financial Accounting Standard Board (FASB) declined to issue a standard addressing this issue when the FASB issued requirements for Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others:

> The [FAS] Board considered whether recipient organizations that are trustees of charitable trusts should recognize an asset or a liability for trust assets but decided that this Statement should not establish standards for accounting by trustees. The Board specified two reasons for that decision. First, a recipient organization that is a trustee may not have an asset because a trustee's ability to obtain the benefits of trust assets is usually significantly limited by its fiduciary responsibilities and by the trust agreement. …Second, current financial reporting requirements for trustees that are banks differ from requirements for trustees that are not-for-profit organizations, primarily in the area of whether the trustees include the assets and liabilities of trusts in their own financial statements.[15]

Regarding the basis of accounting, not-for-profit organizations are required to use the **accrual basis of accounting**.[16] However, the *AICPA Audit Guide: Not-for-Profit Organizations* noted that:

> Some not-for-profit organizations may find that financial statements prepared on the cash basis or the modified cash basis of accounting are adequate for their governing boards and other users. SAS No. 62, Special Reports (AICPA, Professional Standards, vol. 1, AU sec. 623), describes the auditor's reporting requirements when the financial statements are prepared on a comprehensive basis of accounting other than GAAP (OCBOA), including the cash receipts and disbursements basis of accounting and modifications of the cash basis having substantial support. [17]
>
> SAS No. 62 also permits an auditor to issue a special report on financial statements that have been prepared in conformity with the requirements or financial reporting provisions of a governmental regulatory agency but that do not conform with GAAP or constitute OCBOA. In that instance, the auditor's report should include a separate paragraph at the end of the report stating that the report is intended solely for the information and use of those within the entity and the regulatory agency with which the report is being filed, and is not intended to

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[15] FASB Statement 136. par. 80.
[16] *AICPA Audit Guide: Not-for-Profit Organizations*, pars. 12.04 and 13.01-13.05.
[17] Ibid., par. 14.11

be and should not be used by anyone other than these specified parties. Such a restrictive paragraph is appropriate, even though by law or regulation the auditor's report may be made a matter of public record. The auditor may use this form of report, however, only if the financial statements and report are intended solely for filing with the regulatory agency to whose jurisdiction the organization is subject.[18]

Staff analysis:

1) Generally accepted accounting principles require the accrual basis of accounting for the financial statements of not-for-profit organizations. Although the *AICPA Audit Guide: Not-for-Profit Organizations* acknowledged that smaller not-for-profit organizations may not need to produce financial statements in accordance with GAAP, it does not suggest that there should be any change in generally accepted accounting principles, which require the accrual basis of accounting for financial statements. Accordingly, staff recommends that the proposed fiduciary standard, which is intended to promulgate generally accepted accounting principles, not be altered to permit deviations from requirements in existing standards.
2) On a separate issue, unrelated to the basis of accounting: No respondents to the fiduciary activities ED identified any Federal fiduciary activities that resembled "split interest agreements," in which the Federal component entity would be allowed to retain any funds or obtain any benefit from the fiduciary activity. The definition and characteristics of fiduciary activities in the ED would exclude such split or mixed funds.

Insurance Companies

Insurance companies maintain "separate accounts"[19] that fund annuity contracts, pension plans, and similar activities. All life insurance entities are required by state insurance regulations to prepare financial statements in accordance with statutory accounting practices (SAP). Many life insurance entities prepare financial statements in accordance with generally accepted accounting principles (GAAP) to comply with SEC regulations or for other reasons.[20] The hierarchy of SAP includes generally accepted accounting principles in FASB Statements and Interpretations, Accounting Principles Board Opinions, and AICPA Accounting Research Bulletins as "Category A."[21] However, some reports required by regulatory agencies must be prepared on a cash basis, particularly details of income and expense.[22]

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[18] Ibid., par. 14.12

[19] AICPA Accounting Standards Executive Committee *Statement of Position 03-01*, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts,* glossary.

[20] AICPA Audit and Accounting Guide: Life and Health Insurance Entities, par. 3.02.

[21] Ibid., par. 3.04.

[22] 2004 Miller GAAP Guide, *Insurance*, 50.43.

Attachment 3: "Basis of Accounting" from Briefing Materials, December 2004 Board Meeting

The *AICPA Audit and Accounting Guide: Life and Health Insurance Entities* states, "**the assets of a separate account plan are assets of the insurance company** but are not commingled with the insurance company's general assets."[23] FASB Statement 60, *Accounting and Reporting by Insurance Enterprises,* states that, "separate account assets and liabilities ordinarily shall be reported as summary totals in the financial statements of the insurance enterprise."[24]

"Separate accounts" share the characteristics of funds that the Board has previously identified as "earmarked funds." Although they are restricted to a specific purpose, the beneficiaries do not have a legally enforceable right to any specific amount, since payment depends upon events that will happen in the future (such as insurable events or, for annuities, the passage of time). Beneficiaries also do not have the right to make investment decisions related to the "separate accounts." Accordingly, "separate accounts" have little applicability to the proposed fiduciary activities standard.

Staff analysis:
"Separate accounts" are generally subject to GAAP requirements, including the accrual basis of accounting. However, they do not share the characteristics of fiduciary activities and have little applicability to the proposed fiduciary activities standard.

Investment Companies

Investment companies (other than a separate account of an insurance company as defined in the Investment Company Act of 1940) that are separate legal entities are covered by the AICPA *Audit and Accounting Guide: Investment Companies ("Investment Guide")*[25] Several kinds of investment companies exist: management investment companies, unit investment trusts, common (collective) trust funds, investment partnerships, certain separate accounts of life insurance companies, and offshore funds. …Investment companies are organized as corporations, common law trusts (sometimes called business trusts), limited partnerships, limited liability investment partnerships and companies, and other more specialized entities, such as separate accounts of insurance companies that are not in themselves entities at all except in the technical definition of the Investment Company Act of 1940.[26]

The AICPA Investment Guide assumes the accrual basis of accounting, although it notes that "the 1940 Act does not require expenses, income items, or both to be accrued **daily** if their net cumulative amount is **less than one cent** per outstanding share."[27] The illustrative financial statement provided in the AICPA Investment Guide states, "The financial statements are presented on the accrual basis of accounting."[28]

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[23] Ibid., par. 14.24 (bold added).
[24] FASAB Statement 60, par. 54.
[25] AICPA *Audit and Accounting Guide: Investment Companies, "Notice to Readers," page 1.*
[26] Ibid., par. 1.03.
[27] Ibid., par. 2.23 (bold added).
[28] Ibid., par. 9.21.

Attachment 3: "Basis of Accounting" from Briefing Materials, December 2004 Board Meeting

Staff analysis:
To the extent that some investment company trusts resemble Federal fiduciary activities, the accrual basis of accounting is the appropriate basis of accounting.

Staff recommendation:
In the opinion of staff, none of the existing literature provides a substantive basis for the Board to consider promulgating a basis of accounting other than accrual basis for fiduciary activities.

- The closest parallel to Federal fiduciary activities is that of state and local governments, which are required to use the accrual basis of accounting for fiduciary financial statements.
- The scope of the proposed standard is the Federal component entity's financial statements, and not special-purpose reports required by a regulatory agency.

Therefore, staff recommends that the Board retain the guidance regarding basis of accounting contained in the exposure draft at paragraph 41:

Basis of Accounting

> 41. The assets and liabilities reported in the Federal entity's basic financial statements and disclosed in the notes thereto, as required in paragraphs 18-40, should be recognized and measured using the standards provided in generally accepted accounting principles applicable to the Federal Government.

Question for the Board
Does the Board agree with staff recommendation?

<u>Attachment 4:</u>

<u>Exposure Draft, *Accounting for Fiduciary Activities*</u>

Note to website users: the exposure draft, *Accounting for Fiduciary Activities,* is available on the FASAB website under "Exposure Drafts."

Tab F
Attachment 5

Transcript of Public Hearing

August 17, 2005

Revised Exposure Draft, *Accounting for Fiduciary Activities*

FEDERAL ACCOUNTING STANDARDS

ADVISORY BOARD

Public Hearing:

Revised Exposure Draft, *Accounting for Fiduciary Activities*

August 17, 2005

441 G Street, N.W.

Washington, D.C.

Agenda Item: Public Hearing- Fiduciary ED

MR. MOSSO: We can start with the public hearings, Tab A in your binders. Would Eileen Parlow come to the table? Our first comment is from the Department of Defense, right?

MS. PARLOW: The Department of Defense has not arrived yet.

MR. MOSSO: How about Interior? If Interior is here, we could move on to them. Let's give them a few minutes.

MS. COMES: We have a written version of Zack's prepared remarks. One of the things that we have to acknowledge is that with the timing of the public hearing, it is very difficult for people to prepare responses. We somewhat underestimated the degree of difficulty they would have being prepared to comment.

I think that our Interior group is all here now. I apologize for putting you in the hot seat, but if we could go ahead and get started with you, we will take DoD when you're done.

MR. MOSSO: We welcome you all here.

MS. CAREY: I would point out that Mr. Winter is our independent auditor, so he won't be speaking for Interior. He is here to address any specific questions from the audit types.

MR. MOSSO: Very good. We would like for you to keep your opening remarks as brief as possible so we can have time to ask questions. With that, go ahead. Who is going to speak first?

MS. CAREY: I will be speaking. I will be the only one actually giving a statement, which I have just handed out. I will keep it fairly short. I have four main points.

I have with me Margaret Williams, who is the Deputy Special Trustee for Trust Services in the Office of the Special Trustee for American Indians, Burt Edwards, who is the Executive Director of the Office of Historical Trust Accounting, and also Fred Winter, who is a partner with our accounting firm, KP&G.

We have four main comments on the exposure draft. First of all, we would like to thank you very much. We think a lot of progress has been made on this document. We appreciate the attention that was paid to our comments previously regarding trust accounting.

The four points we have is, first of all, the application of the basis of accounting to the trust footnotes. Second is a concern that we have on the scope of the fiduciary definition, which may be removing some items from the balance sheets, beyond which what we had initially thought the standard would be doing. As part of that, we have concerns about the fund balance of Treasury being split between fiduciary and non-fiduciary. These are normally commingled, and it is very difficult from a practical standpoint to break them out.

Our third point would be on the paragraphs related to Minerals Management Service. The fourth comment we won't be discussing here in detail; we think the appendices, especially the discussions of pro forma transactions are too detailed, and we will be putting that in a comment letter before the end of the month.

Regarding the basis of accounting, the paragraph 14 on the surface is pretty benign. It says that the use of standards provided in generally accepted accounting standards are applicable to the federal government. The strict interpretation of that to the Indian Trust Fund is somewhat problematic. We do accruals on the individual Indian money side of interest and other things, because that is the way the funds are managed. Margaret can speak to that in more detail.

But most of the other revenues that we have not received yet, it would be very problematic and very misleading to record those as assets. We have got statements going to the beneficiaries, we have got a lot of published documents discussing the trust fund balances that are pretty much maintained on the same basis as any trust accounting operation is maintained. If we were to report a different set of numbers in the financial statements of the Department of the Interior, this would confuse the beneficiary as to whether or not the numbers they have been provided are correct.

So we would think that the footnote disclosure should be on the same basis of accounting as is performed for the trust operations. As I said, Margaret can speak to that in much more detail.

The second point is the fiduciary definition itself. We did concur with this definition in the last draft. We read it very narrowly when we read it in the last draft, discussions that have taken place in the last couple of years, the fact that the exposure draft currently says that the definition would have brought in payroll withholdings and advances on sales of goods and services, but for the fact that those have been specifically excluded. It indicates to me that the definition is being read by others as being very, very broad.

Our opinion is that basically, the Indian Trust Fund, the Thrift Savings Plan, and maybe some future activity or some unidentified activity of a similar nature should be treated as fiduciary. Everything else we would like to see remain on the balance sheet as an asset with an offsetting liability.

We think that there is a theoretical basis for differentiating those two types of activities. I pointed those out here in points one through three under fiduciary definition. There is an absolute certainty of non-federal ownership. The fact that they are going to purchase federal securities doesn't change that. These are absolutely certain not federally owned.

There is a contractual arrangement that you can point to, pull out, xerox. It may be a law, it may be legislation, it may be a normal contract that you see in the private sector, but there is a contractual arrangement located, looked at and read. This contractual arrangement either implicitly or explicitly requires that a certain level of accountability be met, that far exceeds the accountability for normal pass-through collections. That would be maintenance of a self balancing set of accounts, regular statements, independent audit. There might be other accountability actions that might be taken, but there is a very high standard for accountability.

We believe that this is the level of accountability that should be met in order to qualify as fiduciary and be removed off the balance sheet. Anything that doesn't rise to that level we report as an asset and a liability, especially pass-through type activity, regardless of whether it is related to goods and services or payroll, regardless. If we collect money in the normal course of business, day in and day out, some of that money needs to be passed on to somebody else, and that is why we report a liability. The purpose of a liability is to reflect that.

I think that is normal practice in the private sector also. That is part of accrual accounting.

From a practical standpoint, this can be done either by changing the definition, which would be my preference, or by leaving the definition and changing reporting requirements, and saying that the reporting requirement is balance sheet recognition unless you meet this very high standard. Then you may pull it off the balance sheet.

Other activities may exist that the Board would like to carve out. Interior has no specific comment on these. Some of DoD's activity may be a true escrow account, where they are an independent third party holding money on behalf of two other parties, and this money is not theirs.

There may be seized assets that the Board may want to carve out. We don't really have an opinion on that, except to say that Interior has a number of things that we call escrow accounts, just like the federal government has a number of things they call trust funds. Interior's escrow accounts, we are not acting as an independent third party. Interior's escrow accounts is basically an advance on the sale of goods and services, and we think that would require balance sheet recognition. We would not want to carve that out. So we would not think that our escrow account would meet that high standard of fiduciary, because we are a party to the escrow.

The third point. There are two paragraphs amending the standards for treatments of oil and gas royalties, and is in some way probably amending the custodial statements.

We concur with the objectives of the Board, when MMS oil and gas royalties are removed from the Statement of Net Cost under SFFAS 7. From a practical standpoint, that has been extremely difficult to apply, especially in government-wide reporting. Treasury tends to take our Statement of Changes in Net Position, which shows a portion of these items as pass-through, flowing through our Statement of Net Cost, because we retain a portion of them. Treasury also takes our Statement of Custodial Activity and records all those revenues, and then asks us why our revenue doubled from our initial submission. What they have done is, they have taken the balances off of two different statements, added them together, and told us, you have recorded these numbers twice.

Excluding exchange revenue from the Statement of Net Cost has proven very difficult. We actually think that the treatment of oil and gas royalties should probably be addressed as part of the natural resources project or in some other project. We prefer that it not be attached at this point until full discussion can be given to it.

As I stated earlier, we think the pro forma examples in the appendices may cause confusion, or maybe more details are needed. But I think that is beyond the scope of what I want to talk about here.

MR. MOSSO: Thank you. Questions?

MR. REID: I have a question. Assuming that there are a number of cats and dogs items that this definition would sweep up, and as a result you were required to remove them from your

Balance Sheet, would there be alternate accounting mechanisms that you would have to maintain control over these things?

What I would be concerned about would be that if we remove them from the ledger, that you might be in a position where you were classifying them as a fiduciary, so each one of these things are now sitting on an island somewhere, that we wouldn't have the level of control over that.

MS. CAREY: I think we would dramatically lose control over some of these assets.

MR. REID: There wouldn't be at least not a readily available alternative way of doing the accounting?

MS. CAREY: Not that is apparent to me. It would basically be creating several more self-balancing sets of accounts in the general ledger.

One of the basic controls that I usually have maintained as I am preparing my Balance Sheet, you take the bottom line of the Balance Sheet and you go back to the trial balance and you make sure that those two numbers agree. If we are pulling all these fiduciary activities out of our basic trial balance, that check to make sure you have accounted for your activities is no longer there. You can forget an entire operation and not know it. That is actually the case with the SBR right now. There is no bottom line check on the Statement of Budgetary Resources. What you would be doing here is removing the bottom line check from the Balance Sheet.

MR. MOSSO: Would you have a separate trial balance for fiduciary activities?

MS. CAREY: Having one separate trial balance for one very large fiduciary activity, for example, Indian Trust, is not problematic, because that is a stand-alone audited set of accounts. We have our auditor here; we have statements that go out on a monthly basis.

Having different self- balancing sets of accounts for 20 or 35, however many extra fiduciary activities we have, we would lose control, because they are not necessarily as large, as visible, they don't have the independent audit, they don't have the customer receiving statements. You just don't have that level of control that you would have if it is part of a general ledger.

MR. DACEY: In terms of the nature of some of these other fiduciary activities you have in Interior, could you elaborate a little bit as to what some of those are, particularly those that you may think should be on the Balance Sheet?

MS. CAREY: Some of them –would be miscellaneous collections. Most of the royalty collections would not fit this fiduciary standard. Most of the royalty collections have actually already happened in the federal government. Even if the states or Congress get a cut, they are still federal collections or federal assets that are being sold.

There are small amounts of collections that may be on behalf of a state or local government. One of the issues that came up is, the Office of Surface Mining has an abandoned mine land fund that is primarily earmarked funds, and will be accounted for under the new earmarked fund standards. But there are portions of that that because of the language might meet the fiduciary standard.

So we're going to take the abandoned mine land funds which is being managed as a whole, and will be disclosed mostly as earmarked, and pull a piece of that fund out and just simply not account for them in the same place.

So there are lots of things. The materiality threshold applies, but materiality is something that -- conversations you get into with the auditors as you are preparing the statements, and if you have an error at the end and you think it is too small and they think it is too big, then you start having a discussion of materiality.

As an accountant, I like to report every transaction properly from the get-go, and worry about materiality if there is an issue during the audit.

MR. SCHUMACHER: Could you give us a general idea of the size of the numbers that you would be removing from the Balance Sheet?

MS. CAREY: I would have to go through item by item on what would apply. My fear is that we would come up with some really small items. Again, with materiality we could cover ourselves, but I would prefer to do it in accordance with the standard, regardless of size.

I don't think it would be big dollars.

MR. SCHUMACHER: But in your mind, it is more an issue of control, as opposed to materiality?

MS. CAREY: Yes. I think the new approach to materiality under some new legislation is really taking materiality beyond just simply a number and into some more qualitative factors.

MR. PATTON: Switching focus to the basis of accounting for a minute, you seem to say you don't want to accrue certain receivable types of assets, because it would mislead the beneficiaries. Do the beneficiaries have some sort of ownership interest in receivables?

MS. WILLIAMS: Right now, the way the trust systems work is, they would have an ownership interest, but what they see is the land. What they would see is leases, they have leases on the land. What is reported to them is what is received on the land, not what is due out there someday to them. That is standard industry practice, and that is what the trust systems are geared to do, is report to them what is received on the land.

MR. DACEY: So when you say received, that is the cash?

MS. WILLIAMS: Right, here it is, posted into your account. It is available to you now.

MR. PATTON: I don't know about those rules, so I am arguing just from a basic accrual accounting point of view, that presumably the argument in the handout here has to do with the can't estimate, not certain, that sort of stuff. Presumably you wouldn’t accrue those receivables if they didn't fit the definition of an asset, whatever that turns out to be. And recognition criteria will have some probability issues in it and some measurement issues.

So it seems like the accrual basis would say don't accrue those if they are not certain enough.

MS. WILLIAMS: And the accrual basis would say that. What I am saying is, you wouldn't do that in the trust environment.

To back up a little bit, the footnote disclosure, I believe what we are trying to say is, you wouldn't want to go into the footnote and disclose something different than what you disclosed on the financial statement. On the financial statements you have already disclosed one basis of accounting. This exposure draft, as we have interpreted it, would have us disclosing something in the Interior footnote that would be different.

In addition, what I feel is that it is also asking for a disclosure that is above and beyond what is out there in the industry. Usually what you see in the industry, at least in the banking industry, is a disclosure that says, this bank has a trust department. The trust department has a trust relationship. There’s trust agreements out there, and if there is some type of contingency, which we know the Interior trust has some contingencies, they would disclose that, too, in that footnote. There is a contingency.

What we are seeing here is a disclosure, in my opinion, that is way beyond what is called for in the private sector. Not only beyond, there is a trust agreement, there is a trust agreement, there is a trust relationship, there is a contingency, but let's throw in all this financial information and above and beyond that, put in a basis of accounting that is different than what the financial statements are prepared on. So I think that basically is what our point is.

MR. EDWARDS: Mr. Patton, one of the issues would be, a large percentage of the leases would be, a large percentage of the sub-surface leases, for example, when the lifter of oil and gas lists that, they report the barrels of oil, million cubic feet of gas. They report the price at the wellhead less statutory and contractually agreed-upon offsets, and that comes in.

Well, you never know in a particular month how much they are going to lift. Now, if the money doesn't come in, they do have a way to contact the lifter. Maybe the state of New Mexico closed them down for environmental remediation, or they went through their one-month shutdown every three years for repairs, so nothing came in that month because they didn't lift anything.

Surface leases, many of them, aren't a flat rental. They may be based on the number of animal units that grazed on the land. Out in the Southwest they actually have something analogous to sharecropping, where the landowner gets a share of the economic value of the watermelons or whatever are growing, as opposed to a flat rental. So you are getting into the issues that you mentioned in your comment.

Generally with the tens of thousands literally of leases, the BIA people at the agency level in Albuquerque are aware something didn't come in, it may be a couple of months before they find out exactly why it didn't come in before they would exercise trespass and remove the animals, cut off the oil pumps and so forth.

MS. CAREY: Basically in the private sector trust relationship they wouldn't be including this as a trust asset prior to receipt.

MR. MOSSO: What are you basing that on? You referred to the private sector in a number of cases. Is there any literature on trust accounting out there?

MR. WINTER: Again, from our standpoint, there is a bank savings and loan audit guide out there that does describe trust activity. In fact, there is a separate chapter that deals with trust activities.

Again, as you read through there, the focus is certainly on disclosing on the bank side of the financial statements the trust relationship, in addition determining if there are any contingent liabilities out there associated with the trust agreement associated with that.

Then thirdly, the value is the income that is generated off trustees, which here is just not applicable and everything.

So those are the two focuses for the public companies that are out there in their disclosures. A lot of them do disclose the dollar amount that is held under the trust. That is a disclosure amount, as it would be here in these financial statements. It does not affect the agency that would be disclosing the number on whatever basis of accounting that that is. It is just more of an informational purpose out there, to say there are X dollars under trust. It does not flow up into the financial statements of the agency in any way. In this case, there is really no income associated with that relationship.

MR. MOSSO: You were talking about the bank's statements and contingencies relating to the trust relationship as it might affect the bank.

MR. WINTER: Correct.

MR. MOSSO: But what is the accounting for the trust per se? If the trust presented stand-alone financial statements, what would they do?

MR. WINTER: That is difficult, because really there is no individual audit of the trust department. In the relationship there is a trust department, and they would have thousands or millions of different trust agreements. So those can be in relation to nearly anything.

There may be a specific audit that is done on an individual trust. It could be a group of individuals or whatever the case may be, to make sure that the trust functioned in the way that it was set up. In other words, disbursements were made to the appropriate people and all that. There are what we call individual trust audits, but those are not done in accordance with the issue of GAAP financial statements. Those are done to make sure that the trust performed its fiduciary duties in accordance with the trust agreement there.

That is a common procedure from an auditor standpoint. If I am auditing a bank and they have a trust department, one of the procedures that may be done by the independent auditors, and lots of times is done by our internal audit department of the bank, is to go in and select various trust agreements and then look at, whether it is the receipts or disbursements, in accordance with that specific trust agreement, to see if it was complied with, but not for the purpose of issuing financial statements on the trust department.

MS. WILLIAMS: If I may, I have been at the Interior for coming up on 12 years, and I have converted and brought the Indian Trust Fund up on two private trust systems. I have worked with the vendors on both those systems, and I don't have the numbers exactly because it has been years, but those systems have billions of private sector assets on them.

Both those vendors put me in contact with several private sector banks, and we worked with both of them to come up with a way to produce these financial statements that I had to produce for the Department of the Interior for the requirements. It is just not done. It is like Fred said, it is not done.

Everyone looked at me, both the trust departments in the private sector and the vendors, and said you have got to what? I said, I have got to add up all of the balances in all of these trust accounts and put them on a financial statement and report it.

I literally had to custom program these trust systems, put some custom programming on top of these private sector trust systems to do what I have to do to produce these financial statements.

So what I am saying is, what we are doing is not done out there, exactly. I went through these trust systems. They issue canned reports. I looked for the closest thing you can come to in the private sector to what we do, are regulatory reports on the assets, where they try to add up all the assets that are in the trust accounts, and do some regulatory reporting. But you just don't do what we do in the private sector, like Fred said.

So to say, can you compare us, no, not exactly. What I say when we tell you what we tell you, we have to heavily depend on what is reported to the beneficiaries on the statements, versus what do private trust departments do when they add up all the accounts and report it as a whole. So whether they report to the beneficiaries, they report what they have received. That is why you hear us talk a lot about, they don't report all these contingencies out there, a lot of these what-ifs. They report what has happened.

MR. MOSSO: An account receivable I wouldn't classify as a "contingency." You are talking about uncollectibles. Those are just receivables, I assume.

MS. WILLIAMS: Right. But you can't spend a receivable. What we tend to report to the beneficiaries and what the trust systems are geared to report to the beneficiaries is what is available for you to take out the door and walk away with. The trust systems, you can't walk away with the receivables.

MR. MOSSO: No, but if I'm a beneficiary I might want to know about it.

MS. WILLIAMS: And there are other mechanisms to report things like the ownership of the land, the ownership of the security. We will report things like that to them, but not a receivable.

MR. MOSSO: In other words, if they own the private land, that would be in the financials?

MS. WILLIAMS: That would be in the statement that we would give to them, the beneficiary statement. You own the land. If there is a lease on the land, here is the lease on the land. If you own a security, here is the security and here are the terms oft the security. We report things like that, just not the receivable, if you will.

MR. DACEY: A couple of quick questions. So basically, the statements that are audited, those are on another comprehensive basis of accounting? A principally cash basis?

MR. WINTER: Cash basis, or modified cash basis, yes.

MR. EDWARDS: The investment earnings generally are accrued. The reason is, they are almost solely in the federal government. There is no record of default. I have Bank of America as one of my consultants in my office, and they do the same thing. The reason was, they never had a default on declared dividends in General Motors that they didn't get, so they will credit those. With respect to revenues on surface and sub-surface leases, they don't do that, because they would be guaranteeing a receivable, if you will, that someone then said, I have $10,000 in my account, $2,000 in cash and cash equivalents and $8,000 in receivables, give me the whole $10,000. The bank would in effect be holding the bag on getting that $8,000, that maybe it wasn't paid because the lessee was bankrupt. Maybe there was a flood in the Red River of the North, which happens unfortunately all too often. Normally if you are a grazer, you are not going to pay when the grazing land is under four feet of water. That is not what you bargained for.

So there are so many ambiguities with regard to what Mr. Patton said, that there is probably not a basis even in the private sector for accruing something that would have those kind of contingencies. It takes so long to find them out, by that time you have issued the statements.

MS. CAREY: Basically then, it goes back to what is in the customer statement. If an accrued receivable for interest on a federal security has been credited in the statement, then that is part of what is in the disclosure. But if something has not been credited to their account, then it is not in the disclosure.

MR.DACEY: Part of your point is that you've got this audited set of financials. What's the year-end for the trust funds, 9/30?

MR. EDWARDS: Yes. Here's what they look like. Eileen Parlow has a copy of this. This is probably the most widely pulled down and circulated sub-financial statement in the federal government. It has both the two trust funds in here in all of their glory. So it is not a matter that there isn't reporting.

MS. WILLIAMS: Let me try to clarify it. There are two sets of financial statements in there. The tribal financial statements are on a cash basis. The IIM financial statements are on a modified cash basis. The reason is, the IIM financial statements have a mutual fund type of situation running in them for their money being paid out for the individuals in a mutual fund situation, where there is an accrual going on there, when the interest is paid out to them, a slightly different situation.

MR. DACEY: My other question is in terms of splitting, if you will, the Fund Balance with Treasury. I guess your preference would be to not have any differentiation for any of the fiduciary activities—to put it all in the regular Fund Balance with Treasury?

MS. CAREY: With the exception of these items, which really don't have Fund Balances with Treasury per se, because they are not Federal activities that have appropriations. They might have cash balances or investments. If we take in monies that happen to meet the fiduciary standard, odds are we can't at that moment differentiate what is fiduciary and what is non-fiduciary.

For example, you have identified the largest exception, which is payroll withholding, but when you withhold payroll from an employee, that is not even a cash collection, that is reduction of a cash payment. That is not in a "separate" Treasury account. That is just part of your cash balance that wasn't reduced as much as it might have been.

To try and differentiate that out between fiduciary and non-fiduciary under the current standard, which is bringing in much more than we would envision, would just be an accounting nightmare. That is the purpose of a liability, is to disclose what you owe to other people. You don't really need stand-alone pots of money. I don't have one pot of money for each payable. I have got a whole bunch of Fund Balance with Treasury and I've got a bunch of liabilities, and as the liabilities come due, I pay them.

I think that to try and break that out separately -- unless management currently has a need to break it out separately, then we are already doing it. For example, in the MMS' pseudo escrow accounts, it was by and large related to the sale of goods and services, so most of those would not even be part of this, but I think there are some exceptions. Some of those pseudo escrow accounts are sitting in a separate Treasury fund symbol and are non-commingled in that way, because from a management standpoint we have to segregate them for management needs. We still don't need a separate Fund Balance with Treasury account for that. We have got other mechanisms for maintaining that management control.

MR. DACEY: Is that kind of a sub-ledger for fund balance, or a sub-letter somewhere else that reconciles to Fund Balance with Treasury?

MS. CAREY: What it is, is basically a separate Treasury fund symbol. We had a long-running 20-year escrow account- that we called an escrow account- with the state of Alaska over some disputed collections. We thought they were ours, Alaska thought they were theirs. The battle has raged for 20 years. These were sitting in what we called an escrow account. They were in a separate Treasury fund symbol, they were specifically identified. I don't know whether they were Fund Balance with Treasury or investments or what the exact nature was, but we didn't need a separate SGL account for that. We had a separate Treasury fund symbol that maintained that pot of money.

MR. SCHUMACHER: I just wanted to elaborate on something I thought I heard you say. You currently have funds that qualify as earmarked and are being reported as earmarked funds. Now under the definition of fiduciary activities, a portion of those funds will qualify as fiduciary activities?

MS. CAREY: That is what it is looking like.

MR. SCHUMACHER: So they will no longer qualify -- how do they fall under one definition, and now --

MS. CAREY: It is a large pot of money – abandoned mine lands- it is where we collect taxes. We are expected to either -- we are expected with these taxes that we collect on coal production to basically restore the abandoned coal lands back to health where the producer has defaulted. So we have got this big pot of money, and that is earmarked. But there is a provision in there in certain cases that if there is not enough land to correct or something like that, that the money might go back to somebody. If it might go back to somebody, then it becomes fiduciary. So we don't know where the line is.

If we have got something that depending on what happens 20 years from now, it is either earmarked or fiduciary. Our preference is that it is earmarked. But technically, right now, a portion of this fund might meet the definition of fiduciary.

MR. SCHUMACHER: So they have an ownership interest at this point.

MS. CAREY: At this point, if we have collected this money and somewhere buried in a piece of legislation is a provision that certain parties might get some of it back, under certain conditions that may happen 20 years from now, they have an ownership interest. It is not related to the sale of goods and services, it is not related to payroll withholding, our preference is that this is all earmarked and we would disclose it in its entirety as earmarked. But a portion of it might cross the line.

MR. ZAVADA: I just had a point that I would like to clarify. It sounds like, in terms of the issue of accrual or cash basis accounting, that in terms of the trust funds you are using accrual accounting where you can, where interest is involved, but you are not using it in cases where you have more complex situations like royalties or grazing fees.

MS. CAREY: Those are the two ends of the continuum. Then we have got some of the tribal funds where we are not recording interest because those are stand-alone individual accounts. Is that right?

MS. WILLIAMS: Yes, I wouldn't say that we are using accrual accounting on the tribal funds. I don't think I would go that far to say that. They are very much what is available for them to take out of their accounts is what's posted to their accounts. I don't think that I would feel comfortable saying that is accrual accounting.

MR. ZAVADA: What types of revenue feeds to the tribal funds? Is that royalty based?

MS. WILLIAMS: Yes, they get royalties, they get farm pasture, they have security income, they have the same kind of stuff. They just don't have that mutual fund kind of thing going on like the IIM funds do.

MR. EDWARDS: It is a much larger trust fund, and the tribes -- presumably the CFO of the tribes -- are supposed to instruct us how they would like to have it laddered, in investments if it is invested, or in Treasury overnights. There is never any uninvested cash. Sometimes Margaret and her colleagues have a hard time getting people to make decisions on the investment, but the tribes literally have free withdrawal of their money.

Now, the individual trust fund, there is automatic withdrawals at the point that oil and gas is five dollars or more, and all other sources are revenue at fifteen dollars or more. So the purpose of the individual fund literally is to put money into the Indian country, not hold it. The only money that is held would be minors, where you have a trust fiduciary relationship; you have some accounts in probate at any point in time; you have, sadly, a large number of whereabouts-unknown. This is where Margaret's colleagues would like to send the money out, but you don't know where the owner is. So those are all fairly large divisions of the $250 to $400 million at any point in time that is in that trust fund.

If you looked at the investment aging in the IIM trust fund, the money -- if you get $100 one day, it is paid out- the "sweep" - the next day. Isn't that 24 hours or so?

MS. WILLIAMS: Yes. If I get money today, it will sweep today.

MR. EDWARDS: So money moves through that fun. If it is an adult account holder, not restricted, you know where they are, and they are living- because if they are dead they are held for the probate process, that money comes in and out literally in a matter of hours.

MS. CAREY: They still get a statement showing what has happened, showing the assets – the land and everything.

MS. WILLIAMS: Absolutely. The tribes will get a statement, and the Bureau of Indian Affairs and the Office of Special Trustee, they are in the middle of working and converting systems to add the land to the statements, so that they will be able to see the land and the leases as well. Right now, they see their securities and the terms and when they pay.

MR. REID: If we were to modify the language here so that what would be accrued would simply be the monetary piece, where you would be accruing interest on investments, would that be consistent with what you are doing now, or does that involve additional accruals that you are not currently making?

MS. WILLIAMS: That would involve additional accruals on the tribal statements. I think the point that I wanted to make is, the footnote I would think would be consistent with the basis of the financial statements they are prepared on. Just move into the footnote, summarize information from the financial statements, the audited financial statements.

MR. MOSSO: You mean the current ones?

MS. WILLIAMS: Right, the audited financial statements, move into the footnote information from the current audited financial statements.

MR. REID: That would involve at least two bases of accounting, right? Modified cash and cash?

MS. WILLIAMS: Right.

MR. EDWARDS: Well, it might, depending on how you interpret what GAAP for the federal government would be.

MS. WILLIAMS: Depending on what information you would move into the footnote.

MS. CAREY: That is what we are currently doing right now. We have in the Department of the Interior financial statements a fairly lengthy footnote that does present summarized information out of this report, on the same basis of this report. It is disclosed how it is prepared.

MR. EDWARDS: It is also in the U.S. government-wide. It's the same. It goes from this, which is a full set of statements, into Interior, and from Interior into the U.S. government. I think in both cases it is toward the end of the footnotes, but in all cases the securities and the amount owed to beneficiaries is the same number all the way through all three levels of reporting.

MR. MOSSO: You mentioned some escrow accounts that were really advance payments on goods and services. Wouldn't they qualify as unearned revenue?

MS. CAREY: Yes. Those would be by definition excepted from this definition. But we have some exceptions. We always have exceptions. Part of our job in Interior is to come up with an exception to every possible situation. But yes, most of the MMS royalty escrow accounts would fall under the exception related to the sales of goods and services.

MR. PATTON: In the letter that was in our packet, this is the letter from Dan Fletcher, page two, Tab A, which is covered by Eileen's memo, the question is, do you agree that payroll withholding and garnishments should be excluded from fiduciary reporting requirements? If not, please explain why. You say, we concur that payroll withholding should be excluded. However, we believe this exclusion is conceptually based and should not be presented as an exception. I am trying to understand the conceptual foundation that you'd like to see.

MS. CAREY: Basically, what we are trying to say is that payroll withholdings and trust type sales of goods and services are the very large items, but there is a lot of other pass-through type activity. You can't possibly create an exception for every single type of miscellaneous pass-through activity that may occur.

Rather than saying, if it is really that the payroll be excluded, I would rather see that the definition or the reporting requirements are written as such that anything that is similar to that is excluded because of the wording of the definition, not because of specific exceptions that have been identified for it.

MR. PATTON: I think generally it is a good idea not to have a list of exceptions. You would like the concept to carry the day. What I was trying to get at is, what is the concept in your mind that would reach the conclusion that you prefer?

MS. CAREY: In my mind, if you have got a self balancing set of accounts and an independent audit, it is fiduciary and you can take it off the balance sheet. Anything else that we might be holding on behalf of some other party, I would like to see a liability recorded on the face of our financial statements. I hold that to a pretty high standard.

MR. MOSSO: We need to wrap this up. The Defense people are here. We thank you very much. I'm sure we are going to have to follow up on some of these points.

MS. CAREY: On the Indian Trust, Margaret Williams is pretty much the person to go to; for the others, it should probably be me.

MR. MOSSO: Thank you very much. We will move on to the Department of Defense presentation.

MR. GADDY: My name is Zack Gaddy, and I thank you for inviting me here today to speak to you about this exposure draft. Chairman Mosso, Wendy Comes, I'm not sure of all the others on the Board that I have met, but I know I have talked to at least four on this specific issue in October of 2003. I'm glad to see that most of the concerns we had, we believe have been adequately addressed in the re-released exposure draft.

What we are here to talk to you about this morning are a couple of areas where we think some more clarity might be beneficial. I will go into my prepared remarks, and you can address any questions you may have.

The Department of Defense and I thank you for an opportunity to address the Federal Accounting Standards Advisory Board regarding the revised exposure draft, "Accounting for Fiduciary Activities". This has been a nebulous area of accounting in the federal government and the Department welcomes FASAB guidance that we can employ in order to provide accurate and consistent accounting treatment of our fiduciary activities.

I want to discuss two concerns the DoD has regarding the revised exposure draft. The first concern involves the fact that under the revised exposure draft funds can meet the definition of fiduciary activity but those funds can be excluded from being reported as fiduciary activity by paragraph 13, unearned revenue exclusions. The second concern is the inclusion of appropriated funds deposited in the Federal Reserve Bank interest bearing account for the FMS Trust Fund under the authority of the Arms Export Control Act.

Our first concern addresses paragraph ten, which is the definition of a fiduciary activity and the applicability of the Foreign Military Sales Trust Fund. In concurrence with our testimony from October 8, 2003, the FMS Trust Fund qualifies on all three points as a fiduciary account. The foreign governments participate in the FMS program and have an ownership interest in cash held in the Foreign Military Sales Trust Fund managed by DoD. The foreign governments can enforce their ownership interest in the World Court for breach of fiduciary obligation.

The Department of Defense seeks clarification on the intent of the unearned revenue exclusion provided in paragraph 13, and its specific applicability in the context of the Foreign Military Sales program administered by the DoD. It appears the intent of the Board is to address all dedicated collections as either fiduciary activity in this revised exposure draft or as earmarked funds under Standard 27, Identifying and Reporting Earmarked Funds. If the FMS Trust Fund would be excluded from being fiduciary under paragraph 13, then we would assume it would be the Board's intent that Standard 27 would apply. However, Standard 27 distinguishes itself from fiduciary activity in that the funds are government owned. It is our position that the funds on deposit in the FMS Trust Fund are owned by the foreign government and not the U.S. government.

We request the FASAB to consider the following information. The FMS program is a non-appropriated program through which eligible foreign governments purchase defense articles, services, and training from the United States government. The purchasing government pays all the costs that may be associated with a sale. In essence, there is a government to government agreement, normally documented on a letter of offer and acceptance between the U.S. government and a foreign government. Under FMS, military articles and services, including training, may be provided from DoD stocks or from new procurement. If the DoD requires new procurement, the U.S. government agency or military department assigned cognizance for this case is authorized to enter into a subsequent contractual arrangement with U.S. industry in order to provide the article or service requested. Foreign governments place funds into the FMS Trust Fund based on a forecast of future financial requirements to ensure funds are available when needed. These funds belong to the foreign country and are to be returned if the program is modified or cancelled.

DoD asserts the FMS Trust Fund has a fiduciary responsibility to foreign customers until a U.S. government agency or military department fulfills the contractual requirements with the foreign customer. The foreign country or foreign entity has the right to use and invest their funds as they see fit until funds are expended from the FMS Trust Fund to meet payments to either the U.S. government or the independent contractor. This position is supported by a Comptroller General decision dated October 15, 1980.

Until a military department has provided an item from stock, the foreign government entity can excise control over funds residing in the FMS Trust Fund. At the time a stock item is removed from the military department's inventory, shipped to the foreign entity and billed, the FMS Trust Fund will reimburse the military department for its cost. The military department will record and recognize earned revenue. The FMS Trust Fund maintains the fiduciary funds as a non-federal entity until the federal entity, a military department, performs in accordance with the contract. While the FMS Trust Fund contains funds received in advance of the federal component providing goods or services, we believe the account is fiduciary. Accordingly, the unearned revenue exemption should not apply to activity in the FMS Trust Fund. We recommend paragraph 13 of the revised exposure draft be modified to exclude activities where the fiduciary owner maintains control over the funds.

The second concern of the DoD centers on non-repayable credit funds appropriated specifically to fulfill international agreements. The United States has entered into agreements such as the Camp David accord and made a commitment of funds to a foreign country. Most of these funds are deposited in an interest bearing account in the Federal Reserve Bank in the name of the foreign country in accordance with the Arms Export

Control Act. Some of the funds in the Federal Reserve Bank account are spent outside the foreign military sales arena in accordance with the Arms Export Control Act. The remaining funds are merged into the FMS Trust Fund, again in accordance with the Arms Export Control Act, when required to meet financial requirements of the FMS contracts for goods or services. The country has an ownership interest because it can spend and move the funds as it sees fit within the requirements of the Arms Export Control Act. There is a binding agreement in place and it is supported by statute. It is our position that even though the non-repayable credit funds originated as appropriated funds, once they were expended from the originating appropriation into the Federal Reserve Bank interest bearing account or FMS Trust Fund, the funds meet the definition of fiduciary activity.

In summary, DoD believes FMS funds, whether originating as foreign customer deposits or as appropriated for the purpose of facilitating FMS sales under the definition of fiduciary; and that neither the paragraph 13 exclusion nor Standard 27 applies. DoD would like the FASAB to clarify the revised exposure draft to clearly articulate this position.

MR. MOSSO: Thank you. I take it you are satisfied with the fiduciary accounting for the military sales fund, and what you seek, then, is just clarification or modification that -- our standard would clearly apply to it. Is that fair?

MR. GADDY: That is a fair statement.

MR. MOSSO: Questions from Board members?

MR. JACOBSON: I just have a factual question. On the non-repayable credit funds, when those appropriated funds go into the Federal Reserve Bank, are they treated as an obligation and an outlay?

MR. GADDY: Yes. When they are deposited into the interest bearing account, they are an outlay to the federal government.

MR. DACEY: The fiduciary standard now talks about collections being the start point of fiduciary responsibility, you are saying, basically, that we've disbursed the money; it is the other side in terms of collection, the disbursement that we have a repayment fiduciary responsibility for.

MR. GADDY: Well, it is a disbursement on one set of books, but a collection into the trust fund or the interest bearing account.

MR. DACEY: But that we manage that Trust Fund or the interest bearing account, which is outside the government?

MR. GADDY: Right.

MR. TORREGROSA: My memory is a little poor, but would this affect how the funds are audited?

MR. GADDY: Today there is an audit looking at our reconciliation of Fund Balance with Treasury, our reconciliation of the disbursement and collection activity into the FMS Trust Fund. But from the perspective of an audited financial statement, there is not one produced today. There is a custodial activity report that is done today, and that would continue.

MR. TORREGROSA: So does that mean that foreign military sales are not audited?

MR. GADDY: They are not audited as stand-alone statements today.

MR. ZAVADA: Just to clarify David's point, they are part of -- you are saying that these activities are now treated as custodial activities in doing DoD's department-wide financial statements?

MR. GADDY: They are not part of the DoD-wide financial statements. There is a separate Treasury index for these funds.

MS. DEE: I could probably clarify that a little bit. There is a statement of custodial activity prepared for current year collections minus current year disbursements. That was in an agreement from 1998 that we have been reporting under. We realize it is going to change, but currently that is part of the financial statements, the statement of custodial activity, only current year cash.

MR. ZAVADA: Not the balances?

MS. DEE: No.

MR. ZAVADA: So this would change the accounting for those in the DoD financial statements.

MS. DEE: Change the reporting.

MR. ZAVADA: The reporting.

MR. REID: Currently if a foreign country comes and they want to buy tanks and they send us money, it would show up in the custodial statement as received in the year -- that they sent us the money and the disbursement in the year in which we provided the tanks?

MS. DEE: Yes.

MR. REID: That could be several years apart?

MS. DEE: Yes.

MR. ZAVADA: Just one follow-up question. So you are okay with the accounting for these activities under the standard. You just want in both cases clarification that the standard applies to both of these activities, is that correct?

MR. GADDY: Correct.

MS. PARLOW: I have a Federal component entity question. In the exclusion it does say that assets collected or received by a Federal entity that represent premiums or advance payments for which the Federal component entity is expected to provide goods or services. The Foreign Military Trust Fund is a different kind of entity, and I'm not too clear on whether- I think there might be parts of it that are rolled up into the Department of Defense financial statements, but I believe that much of it is not, but is considered separate Funds Appropriated to the President entity. I think that perhaps because the Foreign Military Trust Fund is not the entity providing the goods or services, that the language in paragraph 13 might be adequate. Maybe you could clarify for us the relationship between DoD and the Foreign Military Sales Trust Fund.

MR. KRAMER: Just to clarify, I think the important point is that DoD is providing the goods and services, and obviously it comes from two sources. One is from stock as Zack indicated, the other is direct procurement from vendors. In the case of those vendors, it is a DoD contract that actually buys the goods and services, the airplanes, the ships and tanks, and actually takes title and then passes it to the foreign country, so in essence it is a federal entity, I think the DoD is purchasing the material and selling it to the foreign customer.

MR. GADDY: The FMS Trust Fund is not buying or selling. The DoD activity is buying or selling. The FMS Trust Fund is a fiduciary account, is holding the funds that ultimately are used to pay for the items, based on billing agreements.

MS. PARLOW: Is the FMS Trust Fund included in your non-entity assets and liabilities on the DoD-wide statements?

MS. DEE: The only thing would be the statements to show the activity for non-entity.

MS. PARLOW: So it is not on your balance sheet.

MR. FARRELL: Ultimately when the sales take place, the disbursement out of the custodial account, that is –being reflected in the statements of DoD

MR. GADDY: That is when you would have current revenue, cost of sales, correct.

MR. MOSSO: The money that goes in by way of the Arms Export Control Act, once it is in the Trust Fund, it serves the same purpose as the direct deposits by the foreign governments, is that right?

MR. GADDY: Correct, it is used to pay for the goods and services that the foreign governments are purchasing from the DoD.

MS. RICE: One clarifying statement. The non-custodial liability is on the balance sheet for the cash that was received during the current year and the disbursement for the current year. That non-entity liability is on the balance sheet. There is a non-entity asset and an offsetting non-entity liability, so it is shown on the DoD balance sheet.

MR. SCHUMACHER: In the FMS accounts, the balance that is sitting there, either waiting to be contractually obligated or is not obligated at this point, who has control of those funds? Does the foreign country have complete control?

MR. FARRELLL: On the second type, the credit funds that are appropriated by the U.S. government, can the foreign entity say, I changed my mind, I don't want to buy military equipment, send me back the money?

MR. KRAMER: No, the money is not theirs. If they do not use the money, it is the U.S. money. It cannot be refunded to a customer.

MS. PARLOW: Once the appropriated funding is transferred to the FMS Trust Fund, I believe the foreign government can control that money. How is that tracked separately? Or is it that once the non-repayable credit funds are transferred into the FMS Trust Fund, after that, would the foreign government be able to control the fund?

MR. KRAMER: I think if you look at it, the same sales agreement is used regardless of whether the funds are paid by the customer or whether it is U.S. appropriated funds. Yes, whether those sources are deposited in the FMS Trust Fund per se, the individual sales agreement identifies whether the financing source is from the customer or from these U.S. appropriated funds. If at the end, let's say they signed an agreement for a million dollars and it was financed with the U.S. appropriated funds, the final value is only $900,000, there is $100,000 available. That is to an account available to the customer to reuse within the purposes of the intentions of those funds, but it is not available just to refund back to them and say now it is your money.

MR. FARRELL: Although their deposits would be refunded.

MR. KRAMER: Their deposits are definitely available to them to be refunded.

MR. DACEY: Maybe this is to Bob Reid, but in the consolidated, does that roll up as a cash asset?

MR. REID: Not if it not in their statements. We only roll up what is physically in the balance sheet.

MR. DACEY: I thought there was some money in the executive office of the President that was counted, but I can't recall.

MR. REID: No, I don't think that we get anything.

MS. PARLOW: Isn't the cash on DoD's balance sheet as non-entity cash? Is that was you said before?

MS. RICE: Yes. Just the net current year activity.

MS. PARLOW: No assets or liabilities, just the activity?

MS. RICE: Correct.

MR. FARRELL: I just have one more on this second type. Have there ever been funds that have not been spent by a foreign government and that have ultimately reverted back to the U.S. economy?

MR. KRAMER: I'm not aware of that.

MR. FARRELL: So there is no country that goes from a "good" list to a "bad" list?

MR. KRAMER: Well, yes. The countries, their programs become suspended and so forth, and the money is basically still being held.

MR. FARRELL: In the Trust Fund?

MR. KRAMER: In the Trust Fund. And they are restricted from reusing them to repurchase anything.

MR. GADDY: It is unusual certainly, but even like with Iran where that did happen, the money stayed in the FMS Trust Fund, and years later it is still being decided whether to use the money and what to do with it. In some cases they have ordered stuff that we ultimately don't deliver to them, but they still end up paying for it.

MR. FARRELL: Sorry?

MR. GADDY: If they ordered F-16s, and for some reason we ultimately didn't ship it to them, they still paid for the F-16s. What ended up with the F-16s I couldn't say, if they ended up going to U.S. inventory or ultimately resold somewhere else. They ordered the F-16s; they ended up paying for the F-16s. That is where it becomes a contingent at the World Court level: I paid for something that you ultimately didn't deliver it to me, so either give me the planes or give me the money.

MR. FARRELL: And that would be equally true for the U.S. appropriated money.

MR. KRAMER: Right.

MS. PARLOW: But the U.S. appropriated money is restricted; I thought that someone here said that the U.S. appropriated money could only be spent on specific items, and if it wasn't spent, then the appropriated money would revert back to the government. MR. KRAMER: Yes, that is our understanding of our legal restrictions, yes, not being refunded to the customer.

MR. FARRELL: The point I was going to make is, if the country out of U.S. appropriated funds ordered an F-16, by the time the F-16 was made we decided not to deliver them because they became a “bad” country-- that is the situation you are talking about.

MR. KRAMER: Right.

MR. MOSSO: OK.

MS. PARLOW: The challenge here is, since this activity does have the characteristics of fiduciary, how we can wordsmith the unearned revenue exclusion in such a way that it would exclude this type of activity, but it wouldn't accidentally sweep in the advances received by every other reimbursable activity of the federal government; do you see what I am saying? Our conception is such that would be difficult. So any ideas you have, either now or subsequent to today, would be appreciated, because that’s pretty challenging.

MR. FARRELL: Maybe here is an answer. Are there any foreign military sales that do not go through this Trust Fund? Are you selling things to Sweden or some countries just because they ask for it and it doesn't go through the Trust Fund?

MR. GADDY: Everything goes through the Trust Fund.

MR. PATTON: That’s not a very satisfying solution.

MR. MOSSO: The unearned revenue exception was also a problem for Interior.

MR. PATTON: I think we need to work on our exclusions paragraph and the basis for conclusion for those exclusions.

MR. DACEY: Is FMS separate from, or not a federal entity? Does the federal entity actually collect the cash, or is it simply going into this FMS account, which we are calling third party? I mean, the definition starts off “collects or receives and subsequently manages,” but I don't know if a credible argument is the fact that the federal government did not receive it, that it went to this FMS Trust Fund, which is not part of the federal entity. I don’t know; I was thinking out loud.

MS. DEE: Those funds are held until the military department incurs an expense to satisfy the contract.

MS. PARLOW: Any inflow is to -- however you want to look at “Funds Appropriated to the President,” even if the funds are held as something other than Fund Balance with Treasury, that the FMS Trust Fund is a federally-managed entity, so I’m not sure they could get out of it on that basis.

MR. REID: The funds themselves are physically in a bank account somewhere, other than the Treasury Department, or do they represent Fund Balance with Treasury?

MR. GADDY: They are for the most part in the FRB.

MR. MOSSO: And the foreign government decides that?

MR. GADDY: Yes. They either go in the FRB, or in some cases a smaller but growing number is the commercial bank accounts where the reserve fund actually resides.

MS. PARLOW: So generally there aren't investments in Treasury securities?

MR. KRAMER: No, it's cash. And it is the foreign customer's choice of whether they have a Federal Reserve Bank interest bearing account and can earn interest or not. If they choose not to, then the money they pay in advance is deposited in the Federal Reserve. But it is in Treasury and it is a non-interest bearing account. Today that is equally about five to six billion in each account.

MR. PATTON: At some point people have mentioned the paragraph 11 statement that fiduciary activities are initiated by fiduciary collections. Somebody made the point, here is one that was initiated by a disbursement or something like that.

I wanted to say that I found Mr. Fletcher's Interior letter on that issue to be compelling, that fiduciary activities are not initiated by collections. They are initiated by this legal trust document. So I think that the image of the fiduciary activities being initiated by collections or disbursements may be inappropriate.

MS. PARLOW: Yes, we can use a different word than initiated.

MR. DACEY: That is the point. Maybe it is not the cash collection, but it is the establishment of the arrangement that is THE key to whether it is fiduciary or not, for the nature of the relationship or as opposed to the actual collection.

MR. MOSSO: I think we have got all the information that we need from you. We will have to do a little wordsmithing. Thank you very much, and we hope that you have a better trip back than you had coming over.